

SEVCON, INC.  
Form 10-Q  
May 13, 2014

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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 March 29, 2014

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

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 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 13, 2014 |
|-------------------------------|-----------------------------|
| Common stock, par value \$.10 | 3,574,765                   |

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## PART I. FINANCIAL INFORMATION

## Item 1 Financial Statements

## CONSOLIDATED BALANCE SHEETS

Sevcon, Inc. and Subsidiaries

(in thousands of dollars except share and per share data)

|   | March<br>29,<br>2014<br>(unaudited) | September<br>30,<br>2013<br>(audited) |
|---|-------------------------------------|---------------------------------------|
| <b>ASSETS</b>   |                                     |                                       |
| Current assets:   |                                     |                                       |
| Cash and cash equivalents   | \$ 1,450                            | \$ 2,062                              |
| Trade receivables, net of allowances for doubtful accounts of \$48 at March 29, 2014 and \$61 at September 30, 2013   | 6,838                               | 6,746                                 |
| Other receivables   | 883                                 | 357                                   |
| Inventories   | 5,965                               | 5,723                                 |
| Prepaid expenses and other current assets   | 2,085                               | 1,862                                 |
| Total current assets  | 17,221                              | 16,750                                |
| Property, plant and equipment, at cost:   |                                     |                                       |
| Land and improvements   | 23                                  | 23                                    |
| Buildings and improvements  | 757                                 | 737                                   |
| Equipment   | 11,517                              | 10,992                                |
|   | 12,297                              | 11,752                                |
| Less: accumulated depreciation  | (10,335 )                           | (9,783 )                              |
| Net property, plant and equipment   | 1,962                               | 1,969                                 |
| Long-term deferred tax assets   | 3,374                               | 3,152                                 |
| Goodwill  | 1,435                               | 1,435                                 |
| Other-long term assets  | 150                                 | 54                                    |
| Total assets  | \$ 24,142                           | \$ 23,360                             |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                     |                                       |
| Current liabilities:  |                                     |                                       |
| Current portion of long term debt   | \$ 49                               | \$ 46                                 |
| Accounts payable  | 4,077                               | 3,880                                 |
| Accrued expenses  | 1,943                               | 2,087                                 |
| Accrued and deferred taxes on income  | -                                   | 47                                    |
| Total current liabilities   | 6,069                               | 6,060                                 |
| Liability for pension benefits  | 8,255                               | 8,354                                 |
| Long term debt  | 1,704                               | 1,728                                 |
| Total liabilities   | 16,028                              | 16,142                                |
| 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 3,574,765 shares at March 29, 2014 and 3,474,388 at September 30, 2013 | 358                                 | 347                                   |
| Premium paid in on common stock   | 5,751                               | 5,699                                 |
| Retained earnings   | 9,241                               | 8,591                                 |
| Accumulated other comprehensive loss  | (7,236 )                            | (7,419 )                              |
| Total stockholders' equity  | 8,114                               | 7,218                                 |
| Total liabilities and stockholders' equity  | \$ 24,142                           | \$ 23,360                             |

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

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## CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

Sevcon, Inc. and Subsidiaries

|   | (in thousands of dollars except per share data) |                |                  |                |
|---|---|----------------|------------------|----------------|
|   | Three months ended                              |                | Six months ended |                |
|   | March 29, 2014                                  | March 30, 2013 | March 29, 2014   | March 30, 2013 |
| Net sales                                     | \$9,170   | \$8,017        | \$18,219         | \$14,657       |
| Cost of sales                                 | (5,568)   | (5,010)        | (10,785)         | (9,410)        |
| Gross profit                                  | 3,602   | 3,007          | 7,434            | 5,247          |
| Selling, research and administrative expenses | (3,406)   | (2,865)        | (6,528)          | (6,290)        |
| Restructuring charge                          | -   | (605)          | -                | (605)          |
| Operating income (loss)                       | 196   | (463)          | 906              | (1,648)        |
| Interest expense                              | (19)  | (26)           | (35)             | (50)           |
| Interest income                               | 1   | 1              | 1                | 1              |
| Foreign currency loss                         | (39)  | (88)           | (124)            | (289)          |
| Income (loss) before income tax               | 139   | (576)          | 748              | (1,986)        |
| Income tax benefit (provision)                | 23  | 638            | (98)             | 746            |
| Net income (loss)                             | 162   | 62             | 650              | (1,240)        |
| Basic income (loss) per share                 | \$0.05  | \$0.02         | \$0.19           | \$(0.37)       |
| Fully diluted income (loss) per share         | \$0.05  | \$0.02         | \$0.19           | \$(0.37)       |

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

Sevcon, Inc. and Subsidiaries

|  | (in thousands of dollars) |                |                  |                |
|--|---------------------------|----------------|------------------|----------------|
|  | Three months ended        |                | Six months ended |                |
|  | March 29, 2014            | March 30, 2013 | March 29, 2014   | March 30, 2013 |
| Net income (loss)  | 162                       | 62             | 650              | (1,240)        |
| Other comprehensive income:  |                           |                |                  |                |
| Foreign currency translation adjustment  | 30                        | 20             | 96               | 121            |
| Defined benefit pension plans:   |                           |                |                  |                |
| Actuarial loss, net of \$13 and \$26 tax benefit for the three and six month periods, respectively, (2013: net of \$18 and \$37 tax benefit for the three and six month periods, respectively) | 44                        | 50             | 87               | 103            |
| Comprehensive income (loss)  | \$236                     | \$132          | \$833            | \$(1,016)      |

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

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## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

Sevcon, Inc. and Subsidiaries

|   | (in thousands of<br>dollars) |                      |
|---|------------------------------|----------------------|
|   | Six months<br>ended          |                      |
|   | March<br>29,<br>2014         | March<br>30,<br>2013 |
| Cash flow from operating activities:  |                              |                      |
| Net income (loss)   | \$650                        | \$(1,240)            |
| Adjustments to reconcile net income (loss) to net cash used by operating activities:    |                              |                      |
| Depreciation  | 304                          | 309                  |
| Gain on sale of fixed assets  | -                            | (3 )                 |
| Stock-based compensation  | 127                          | 168                  |
| Pension contributions greater than pension expense                                      | (195 )                       | (20 )                |
| Deferred tax provision (benefit)  | 98                           | (912 )               |
| Increase (decrease) in cash resulting from changes in operating assets and liabilities: |                              |                      |
| Trade receivables   | 18                           | (300 )               |
| Other receivables   | (526 )                       | -                    |
| Inventories   | (136 )                       | 115                  |
| Prepaid expenses and other current assets   | (530 )                       | 54                   |
| Accounts payable  | 99                           | (52 )                |
| Accrued expenses  | (167 )                       | 207                  |
| Accrued and deferred taxes on income  | (83 )                        | 147                  |
| Net cash used by operating activities   | (341 )                       | (1,527)              |
| Cash flow used by investing activities:   |                              |                      |
| Acquisition of property, plant and equipment  | (249 )                       | (307 )               |
| Proceeds of sale of fixed assets  | -                            | 4                    |
| Net cash used by investing activities   | (249 )                       | (303 )               |
| Cash flow used by financing activities:   |                              |                      |
| Repayments of long term debt  | (23 )                        | (21 )                |
| Purchase and retirement of common stock   | (63 )                        | (53 )                |
| Net cash used by financing activities   | (86 )                        | (74 )                |
| Effect of exchange rate changes on cash   | 64                           | 83                   |
| Net decrease in cash  | (612 )                       | (1,821)              |
| Beginning balance - cash and cash equivalents   | 2,062                        | 2,823                |
| Ending balance - cash and cash equivalents  | \$1,450                      | \$1,002              |
| Supplemental disclosure of cash flow information:                                       |                              |                      |
| Cash paid for income taxes  | \$83                         | \$3                  |
| Cash paid for interest  | 35                           | 50                   |

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

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SEVCON, INC.

Notes to Consolidated Financial Statements – March 29, 2014

(Unaudited)

(1)Basis of presentation

Sevcon, Inc. (“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. 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, Sevcon, Inc. 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 consolidated financial statements contain all adjustments (consisting of only normally recurring accruals) necessary to present fairly the financial position of Sevcon, Inc. as of March 29, 2014 and the results of operations and cash flows for the six months ended March 29, 2014. These unaudited interim financial statements should be read in conjunction with the 2013 annual consolidated financial statements and related notes included in the 2013 Sevcon, Inc. Annual Report filed on Form 10-K (the “2013 10-K”). Unless otherwise indicated, each reference to a year means the Company’s fiscal year, which ends on September 30.

The results of operations for the six month period ended March 29, 2014 are not necessarily indicative of the results to be expected for the full year.

(2)Summary of significant accounting policies

There have been no changes since the end of 2013 to the significant accounting policies followed by Sevcon, Inc.

(3)Stock-based compensation plans

Under the Company’s 1996 Equity Incentive Plan (the “Plan”) there were 183,400 shares reserved and available for grant at March 29, 2014. There were 106,000 shares reserved and available for grant at March 30, 2013. There were no options granted or exercised in the periods ended March 29, 2014 and March 30, 2013.

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.



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A summary of option activity for all plans for the six months ended March 29, 2014 is as follows:

|  | Shares<br>under<br>Option | Weighted<br>average<br>Exercise<br>Price | Weighted<br>average<br>contractual<br>life<br>(years) | Aggregate<br>Intrinsic<br>Value |
|--|---------------------------|--|---|---------------------------------|
| Outstanding at September 30, 2013                  | 5,000                     | \$ 5.40                                  | 0.1 years   | \$ -                            |
| Cancelled  | (5,000)                   | 5.40                                     | -   | -                               |
| Outstanding at March 29, 2014                      | -                         | \$ -                                     | -   | \$ -                            |
| Exercisable at March 29, 2014                      | -                         | \$ -                                     | -   | \$ -                            |
| Exercisable and expected to vest at March 29, 2014 | -                         | \$ -                                     | -   | \$ -                            |

The aggregate intrinsic value, if any, 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 \$11.36 and \$4.85 closing market price of the Company's common stock at March 29, 2014 and September 30, 2013, respectively.

In December 2013, the Company granted 80,000 shares of restricted stock to seven employees, which will vest in five equal instalments so long as the employee is then employed by the Company, or as determined by the Compensation Committee. The estimated fair value of the stock measured on the date of grant was \$354,000, based on the fair market value of the stock on the date of issue. The unvested compensation is being charged to income on a straight line basis over five years. The charge to income for this employee restricted stock in the first six months of 2014 was \$35,000 and the subsequent charge will be approximately \$18,000 on a quarterly basis.

In February 2014, the Company granted 28,600 shares of restricted stock to eleven non-employee directors, which will vest on the day before the 2015 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 \$213,000, 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 2014 was \$18,000 and the subsequent charge will be approximately \$53,000 on a quarterly basis.

A summary of restricted stock activity for the six months ended March 29, 2014 is as follows:

|   | Number of<br>shares of<br>Restricted<br>Stock | Weighted<br>Average<br>Grant-Date<br>Fair<br>Value |
|---|---|--|
| Non-vested balance as of September 30, 2013 | 103,800                                       | \$ 5.05  |
| Granted                                     | 108,600                                       | \$ 5.23  |
| Vested                                      | (43,800 )                                     | \$ 4.63  |
| Non-vested balance as of March 29, 2014     | 168,600                                       | \$ 5.27  |

Stock-based compensation expense was \$68,000 and \$127,000 for the three and six month periods ended March 29, 2014 and \$97,000 and \$168,000 for the three and six month periods ended March 30, 2013. At March 29, 2014, there was \$812,000 of unrecognized compensation expense related to restricted stock granted under the Plan. The Company expects to recognize that cost over a weighted average period of 3.1 years.



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## (4) Cash dividends

The Board of Directors suspended dividends to conserve cash during the global recession that began in 2009 and 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 |                |
|   | March 29, 2014                       | March 30, 2013 | March 29, 2014   | March 30, 2013 |
| Net income (loss)   | \$162                                | \$62           | \$650            | \$(1,240)      |
| Weighted average shares outstanding – basic   | 3,401                                | 3,363          | 3,388            | 3,351          |
| Basic income (loss) per share   | \$0.05                               | \$0.02         | \$0.19           | \$(0.37 )      |
| Common stock equivalents  | 90                                   | -              | 64               | 2              |
| Weighted average shares outstanding – diluted   | 3,491                                | 3,363          | 3,452            | 3,353          |
| Diluted income (loss) per share   | \$0.05                               | \$0.02         | \$0.19           | \$(0.37 )      |
| No. of options that are anti-dilutive excluded from calculation of common stock equivalents | -                                    | -              | -                | -              |

## (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 those described in Note 1 to the Notes to Consolidated Financial Statements in the 2013 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 March 29, 2014 |            |           |         |
|                             | Controls                          | Capacitors | Corporate | Total   |
| Sales to external customers | \$8,601                           | 569        | -         | \$9,170 |
| Inter-segment revenues      | -                                 | 2          | -         | 2       |
| Operating income (loss)     | 190                               | 104        | (98 )     | 196     |
| Identifiable assets         | 22,220                            | 1,341      | 581       | 24,142  |
|                             | Three months ended March 30, 2013 |            |           |         |
|                             | Controls                          | Capacitors | Corporate | Total   |
| Sales to external customers | 7,581                             | 436        | -         | 8,017   |
| Inter-segment revenues      | -                                 | 4          | -         | 4       |

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|                     |        |       |        |        |
|---------------------|--------|-------|--------|--------|
| Operating loss      | (293 ) | (7 )  | (163 ) | (463 ) |
| Identifiable assets | 20,242 | 1,147 | 491    | 21,880 |

Six months ended March 29, 2014

|                             | Controls | Capacitors | Corporate | Total    |
|-----------------------------|----------|------------|-----------|----------|
| Sales to external customers | \$17,136 | \$ 1,083   | \$ -      | \$18,219 |
| Inter-segment revenues      | -        | 2          | -         | 2        |
| Operating income (loss)     | 839      | 144        | (77 )     | 906      |
| Identifiable assets         | 22,220   | 1,341      | 581       | 24,142   |

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|                             | Six months ended March 30, 2013 |            |           |          |
|-----------------------------|---------------------------------|------------|-----------|----------|
|                             | Controls                        | Capacitors | Corporate | Total    |
| Sales to external customers | \$13,783                        | \$ 874     | \$ -      | \$14,657 |
| Inter-segment revenues      | -                               | 6          | -         | 6        |
| Operating loss              | (1,436 )                        | (21 )      | (191 )    | (1,648 ) |
| Identifiable assets         | 20,242                          | 1,147      | 491       | 21,880   |

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

(in thousands of dollars)

|  | Three Months ended |                | Six Months ended |                |
|--|--------------------|----------------|------------------|----------------|
|  | March 29, 2014     | March 30, 2013 | March 29, 2014   | March 30, 2013 |
| Electronic controls for zero emission and hybrid electric vehicles | \$6,555            | \$6,043        | \$13,139         | \$10,128       |
| Accessory and aftermarket products and services                    | 2,046              | 1,538          | 3,997            | 3,655          |
| Total electronic controls segment revenues                         | \$8,601            | \$7,581        | \$17,136         | \$13,783       |

(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 |                |
|--|--------------------|----------------|------------------|----------------|
|  | March 29, 2014     | March 30, 2013 | March 29, 2014   | March 31, 2013 |
| Research and development expense, net of grants receivable | \$1,083            | \$1,004        | \$2,013          | \$2,087        |
| Percentage of sales  | 12 %               | 13 %           | 11 %             | 14 %           |

In recent years the Company has received several awards of research and development grants by the Technology Strategy Board, a public body established by the U.K. government to stimulate technology-enabled innovation.

In 2011, the Company was awarded a research and development grant by the Technology Strategy Board to lead a collaborative project with Cummins Generator Technologies and Newcastle University in the U.K. to develop an innovative electric drive system for electric vehicles using advanced switched reluctance motor technology. The Company recorded grant income from this Technology Strategy Board project of \$16,000 and \$33,000 in the three and six month periods ended March 29, 2014, respectively, associated with research and development expense of \$47,000 and \$97,000, respectively, in the same periods. The Company recorded grant income of \$38,000 and \$44,000 in the three and six month periods ended March 30, 2013, respectively, associated with research and development expense of \$111,000 and \$130,000, respectively, in the same periods.

In 2013, the Company was awarded a research and development grant by the Technology Strategy Board as one of a consortium of organizations in the U.K to research and design ultra-efficient systems for electric and hybrid vehicles. The Company recorded grant income from this Technology Strategy Board project of \$2,000 and \$3,000 in the three and six month periods ended March 29, 2014, respectively, associated with research and development expense of \$7,000 and \$10,000, respectively, in the same periods. The Company did not record any grant income or incur any research and development expense in respect of this grant in the first six months of 2013.

In July 2013, the Company was awarded a grant of approximately \$480,000 by the Low Emission Transport Collaborative Projects Fund, a U.K. government body. The grant is to develop next-generation controls for high-voltage, low-power applications. This grant will defray part of the research and development expense associated with this project over the period from July 2013 to March 2015. The Company recorded grant income from this project of \$139,000 and \$236,000 in the three and six month periods ended March 29, 2014, respectively, associated with research and development expense of \$547,000 and \$969,000, respectively, in the same periods. The Company did not record any grant income or incur any research and development expense in respect of this grant in the first six months of 2013.

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The grant income in the first six months of 2014 and 2013 was recorded as a reduction of research and development expense.

## (8) Employee benefit plans

Sevcon has defined contribution plans covering the majority of its U.S. and U.K. employees in the controls business. There is also a small defined contribution plan covering senior managers in the capacitor business. The Company has frozen U.K. and U.S. defined benefit plans for which no future benefits are being earned by employees. The following table sets forth the components of the net pension cost for the three and six month periods ended March 29, 2014 and March 30, 2013, respectively:

|  | (in thousands of dollars) |       |            |       |
|--|---------------------------|-------|------------|-------|
|  | Three Months              |       | Six Months |       |
|  | ended                     |       | ended      |       |
|  | March                     | March | March      | March |
|  | 29,                       | 30,   | 29,        | 30,   |
|  | 2014                      | 2013  | 2014       | 2013  |
| Interest cost                          | \$325                     | \$313 | \$643      | \$636 |
| Expected return on plan assets         | (327)                     | (297) | (647)      | (590) |
| Amortization of net loss               | 57                        | 68    | 113        | 140   |
| Net periodic benefit cost              | 55                        | 84    | 109        | 186   |
| Net cost of defined contribution plans | \$132                     | \$121 | \$247      | \$243 |
| Net cost of all employee benefit plans | \$187                     | \$205 | \$356      | \$429 |

The following table sets forth the movement in the liability for pension benefits in the six month periods ended March 29, 2014 and March 30, 2013:

|   | (in thousands of dollars) |        |
|---|---------------------------|--------|
|   | Six Months                |        |
|   | ended                     |        |
|   | March                     | March  |
|   | 29,                       | 30,    |
|   | 2014                      | 2013   |
| Liability for pension benefits at beginning of period | 8,354                     | 10,264 |
| Net periodic benefit cost                             | 109                       | 186    |
| Plan contributions                                    | (304 )                    | (206 ) |
| Recognition of net actuarial loss                     | (113 )                    | (140 ) |
| Effect of exchange rate changes                       | 209                       | (586 ) |
| Balance at end of period                              | 8,255                     | 9,518  |

Amounts recognized in the balance sheet consist of:

|                         | (in thousands of dollars) |         |
|-------------------------|---------------------------|---------|
|                         | March                     | March   |
|                         | 29,                       | 30,     |
|                         | 2014                      | 2013    |
| Non-current liabilities | \$8,255                   | \$9,518 |

Amounts recognized in accumulated other comprehensive loss consist of:

|  | (in thousands of dollars) |       |            |        |
|--|---------------------------|-------|------------|--------|
|  | Three                     |       | Six Months |        |
|  | Months                    |       | ended      | ended  |
|  | ended                     | March | March      | March  |
|  | 29,                       | 30,   | 29,        | 30,    |
|  | 2014                      | 2013  | 2014       | 2013   |
| Actuarial loss, net of \$13 and \$26 tax benefit for the three and six month periods, respectively, (2013: net of \$18 and \$37 tax benefit for the three and six month periods, respectively) | \$44                      | 50    | \$87       | 103    |
|  | \$44                      | \$ 50 | \$87       | \$ 103 |



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Sevcon, Inc. contributed \$100,000 to its frozen U.S. defined benefit plan in the six months ended March 29, 2014; it presently anticipates contributing a further \$100,000 to fund its U.S. plan in the remainder of fiscal 2014. In addition, employer contributions to the U.K. defined benefit plan were \$204,000 in the first six months and are estimated to total \$494,000 in 2014.

The table below presents information about the Company's pension plan assets measured and recorded at fair value as of March 29, 2014 and indicates the fair value hierarchy of the inputs utilized by the Company to determine the fair values.

|   | (in thousands of dollars)         |                                 |                       |
|---|-----------------------------------|---------------------------------|-----------------------|
|   | Level 1*                          | Level 2**                       | Level 3***            |
|   | (Quoted prices in active markets) | (Significant observable inputs) | (Unobservable inputs) |
| <b>Mutual Funds</b>   |                                   |                                 |                       |
| Standard Life Pension Global Absolute Returns Strategies Fund | 7,006                             | -                               | -                     |
| Standard Life U.K. Indexed Linked Fund                        | 1,773                             | -                               | -                     |
| Standard Life Long Corporate Bond Fund                        | 1,716                             | -                               | -                     |
| CF Ruffer Absolute Return Fund                                | 7,106                             | -                               | -                     |
| U.S. Equity Funds   | 327                               | -                               | -                     |
| U.S. Mutual Funds and Fixed Income Funds                      | 2,393                             | -                               | -                     |
| <b>Other Types of Investments</b>                             |                                   |                                 |                       |
| Cash  | 197                               | -                               | -                     |
| <b>Total</b>  | <b>20,518</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 have been, or are expected, to be paid:

|             | (in thousands of dollars) |
|-------------|---------------------------|
| 2014        | \$ 497                    |
| 2015        | 618                       |
| 2016        | 653                       |
| 2017        | 646                       |
| 2018        | 646                       |
| 2019 – 2023 | 3,296                     |

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## (9) Inventories

Inventories, net of reserve, were comprised of:

|                 | (in thousands of<br>dollars) |           |
|-----------------|------------------------------|-----------|
|                 | March                        | September |
|                 | 29,                          | 30,       |
|                 | 2014                         | 2013      |
| Raw materials   | \$2,255                      | \$ 2,201  |
| Work-in-process | 17                           | 11        |
| Finished goods  | 3,693                        | 3,511     |
|                 | \$5,965                      | \$ 5,723  |

## (10) Other receivables

Other receivables of \$883,000 at March 29, 2014 include \$558,000 of receivables in the Company's French subsidiary that have been reclassified from trade receivables. In January 2014 management was advised that SITL, a customer of the Company's French subsidiary and a manufacturer of on-road electric vehicles, had entered administration protection for a minimum period of six months. The Company has submitted a claim with the French court appointed administrator for the full amount of the receivable of \$558,000 and no resolution is expected for at least another month from the date of this filing. In late April 2014, the Commercial Court in Lyon gave Sevcon the option to recover from SITL the entire inventory of material represented by the receivable of \$558,000. The inventory concerned represents current saleable product and, in the opinion of management, could be sold by the Company's French subsidiary to alternative customers in a reasonable timescale. Due to the high level of uncertainty at this time, management has not assessed a reserve for an uncollectible amount, but any loss incurred may be up to the amount recorded at March 29, 2014, of \$558,000 less the value of the inventory that would be recovered from SITL should the Company exercise its option to do so.

## (11) 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 March 29, 2014 approximates fair value due to the short-term nature of these instruments. The fair value of the Company's long term debt at March 29, 2014 approximated \$1,753,000 (the carrying value on the consolidated balance sheet at March 29, 2014) based on recent financial market pricing. The long term debt represents a level 2 liability in accordance with the fair value hierarchy described in Note 8.

## (12) Accrued expenses

Set out below is an analysis of other accrued expenses at March 29, 2014 and September 30, 2013, which shows separately any items in excess of 5% of total current liabilities:

|  | (in thousands of<br>dollars) |           |
|--|------------------------------|-----------|
|  | March                        | September |
|  | 29,                          | 30,       |
|  | 2014                         | 2013      |
| Accrued compensation and related costs | \$1,074                      | \$ 1,015  |
| Other accrued expenses                 | 869                          | 1,072     |

\$1,943 \$ 2,087

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## (13)Warranty reserves

Warranty reserves are included on the balance sheet within accrued expenses; the movement in warranty reserves was as follows:

|  | (in thousands of dollars) |        |            |        |
|--|---------------------------|--------|------------|--------|
|  | Three                     |        | Six Months |        |
|  | Months                    |        | Months     |        |
|  | ended                     |        | ended      |        |
|  | March                     | March  | March      | March  |
|  | 29,                       | 30,    | 29,        | 30,    |
|  | 2014                      | 2013   | 2014       | 2013   |
| Warranty reserves at beginning of period   | \$ 139                    | \$ 106 | \$ 138     | \$ 89  |
| Decrease in beginning balance for warranty obligations settled during the period | ( 1 )                     | ( 7 )  | ( 44 )     | ( 15 ) |
| Foreign currency translation adjustment  | 1                         | ( 4 )  | 2          | ( 1 )  |
| Net increase (decrease) in warranty reserves for products sold during the period | 1                         | ( 5 )  | 44         | 17     |
| Warranty reserves at end of period   | \$ 140                    | \$ 90  | \$ 140     | \$ 90  |

## (14)Debt

At March 29, 2014, the Company had \$53,000 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 of \$4,000 comprising interest and principal for a five year period commencing in May 2010. Of the total amount outstanding at March 29, 2014, \$49,000 is shown in the current liabilities section of the accompanying consolidated balance sheet under current debt, representing the principal element of the loan installments ending on March 31, 2015. Included in other long term liabilities at March 29, 2014, is \$4,000 which represents the principal element of the loan installments payable in fiscal year 2015. The fair market value of the debt at March 29, 2014 was \$53,000.

The Company's wholly owned subsidiary, Sevcon USA, Inc., has a \$3,500,000 secured revolving credit facility with RBS Citizens, National Association for working capital and general corporate purposes. The loan and security agreement will expire on June 14, 2017 when all outstanding principal and unpaid interest will be due and payable in full. The facility may be paid before maturity in whole or in part at the option of Sevcon USA, Inc., without penalty or premium. Interest on the loan is payable monthly, and in the second quarter of 2014, was calculated at a margin of 3.125% over LIBOR. Under the facility, Sevcon USA, Inc. must maintain, on a quarterly basis, a debt to tangible net worth ratio of no more than 2.40:1 and a debt service coverage ratio of no less than 1.25:1 for each rolling twelve-month period. Upon entering into the revolving credit facility, Sevcon USA, Inc. drew down \$1,700,000, which was the total amount outstanding at March 29, 2014. This \$1,700,000 is shown in the accompanying consolidated balance sheet under long-term debt. The carrying value of the debt approximated to fair value based on current interest rates.

In July 2013, the Company's U.K. bank renewed the overdraft facilities of the Company's U.K. controls and capacitor subsidiaries. The facilities total \$1,495,000 and are secured by real estate owned by those companies. In common with bank overdrafts in Europe, the renewal of the facilities is for a twelve month period although in line with normal practice in Europe, they can be withdrawn on demand by the bank. The facilities were unused at March 29, 2014.

Annual principal payments on long term debt at March 29, 2014 are as follows:

Fiscal year

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|       | (in<br>thousands<br>of dollars) |
|-------|---------------------------------|
| 2015  | 4                               |
| 2016  | -                               |
| 2017  | 1,700                           |
| Total | 1,704                           |

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(15) 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, the issuance date of these financial statements. 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. Important factors that could cause these statements not to be realized include the risks discussed under "Risk Factors" below and others discussed in this report.

CRITICAL ACCOUNTING ESTIMATES

As of March 29, 2014, there have been no material changes to the critical accounting estimates described in the Company's 2013 10-K. However, if the business and economic realities vary from those assumed in these judgments and estimates, actual operating results may differ materially from the amounts derived from these judgments and estimates. In addition, if the continuing worldwide economic troubles continue 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; or
- (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.

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## OVERVIEW OF SECOND QUARTER AND FIRST SIX MONTHS

## Results of Operations

Three months ended March 29, 2014 and March 30, 2013

The following table compares the results by segment for the three months ended March 29, 2014 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: |          |        |
|--|--------------------|----------------|---|----------|--------|
|  | March 29, 2014     | March 30, 2013 | Total                                       | Currency | Volume |
| <b>Sales:</b>  |                    |                |   |          |        |
| Controls - to external customers   | \$8,601            | \$7,581        | 13  | 4        | 9      |
| Capacitors - to external customers   | 569                | 436            | 31  | 9        | 22     |
| Capacitors - inter-segment   | 2                  | 4              | (50 )                                       | 2        | (52 )  |
| Capacitors – total   | 571                | 440            | 30  | (9 )     | 21     |
| Total sales to external customers  | 9,170              | 8,017          | 14  | 4        | 10     |
| <b>Gross Profit:</b>   |                    |                |   |          |        |
| Controls   | 3,315              | 2,856          | 16  | (4 )     | 20     |
| Capacitors   | 287                | 151            | 90  | 11       | 79     |
| Total  | 3,602              | 3,007          | 20  | (3 )     | 23     |
| <b>Selling, research and administrative expenses and restructuring charge:</b> |                    |                |   |          |        |
| Controls   | (3,125)            | (3,149)        | 1   | (4 )     | 5      |
| Capacitors   | (183 )             | (158 )         | (16 )                                       | (7 )     | (8 )   |
| Unallocated corporate expense  | (98 )              | (163 )         | 40  | -        | 40     |
| Total  | (3,406)            | (3,470)        | 2   | (4 )     | 6      |
| <b>Operating income (loss):</b>  |                    |                |   |          |        |
| Controls   | 190                | (293 )         | 165   | (84 )    | 249    |
| Capacitors   | 104                | (7 )           | NM  | NM       | NM     |
| Unallocated corporate expense  | (98 )              | (163 )         | 40  | -        | 40     |
| Total  | 196                | (463 )         | 142   | (52 )    | 194    |
| Other income and expense   | (57 )              | (113 )         | 50  | (2 )     | 52     |
| Income (loss) before income tax  | 139                | (576 )         | 124   | (42 )    | 166    |
| Income tax benefit   | 23                 | 638            | (96 )                                       | -        | (96 )  |
| Net income (loss)  | \$162              | \$62           | 162   | (392 )   | 554    |

Sales in the second quarter of 2014 were \$9,170,000 compared to \$8,017,000 in the same quarter last year. This increase was mainly in our controls business and largely reflected higher sales to customers in our traditional off-road markets of aerial work platform and fork lift truck, as well as higher demand for on-road applications. Sales growth of 12% in both the off-road and four-wheel on-road sectors of our business combined was lower than anticipated although we saw growth in controller shipments in excess of 30% for two-wheel on-road applications such as electric scooters and motorcycles. As in the first fiscal quarter, this sales growth in two-wheel on-road applications was driven by increased European and Asian demand in scooter applications and by our business with motorcycle manufacturers in North America. Foreign currency fluctuations increased reported sales in the second fiscal quarter by \$331,000, or 4%, mainly due to a weaker U.S. Dollar compared to both the British Pound and the Euro than in the prior year period.

In the controls business segment, sales were higher than the second quarter last year in all three of our main geographic markets. Excluding foreign currency effects, sales in the Far East increased 82% driven by stronger product demand for aerial work platform applications in China and Japan. Sales in Europe increased 5% from the second quarter last year, also reflecting stronger aerial work platform business, as well as continued modest growth in product demand for four-wheel on-road EV applications. Sales increased 7% from the second quarter last year in North America driven largely by an increase in sales of 160% to two-wheel, on-road OEM's which more than offset a combined reduction in sales of 32% in the traditional areas of aerial work platform, airport ground support and the mining sector.

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The second quarter of 2014 marked Sevcon's fifth consecutive quarter of sequential revenue growth. We believe that underlying demand is slowly gathering strength in the majority of our markets worldwide and our business continues to benefit from having a low-cost, flexible manufacturing model. However, we cannot predict the timing or the magnitude of any potential resulting improvements in our revenues or margin.

In the capacitor business, volumes shipped were 31% higher compared to the second quarter last year, largely reflecting continuing higher demand from railway signaling customers.

Gross profit of \$3,602,000 was 39.3% of sales in the second quarter, compared to \$3,007,000 or 37.5% of sales in the same quarter last year. The increase in the gross profit percentage compared to the prior year was due to improved sales mix in both the controls business and the capacitor business and the impact of the cost savings implemented in the controls division in the second quarter last year.

Selling, research and administrative expenses in the second quarter increased by \$541,000 from the second quarter of fiscal 2013, this increase largely reflects continued investment in engineering and research and development resources, including the hiring of additional engineering staff. Engineering and research and development expense as a percentage of total sales was 12% in the second quarter of fiscal 2014, compared with 13% in the same period last year. In addition, the Company recorded grant income of \$157,000 in the second quarter of 2014 compared to \$38,000 in the same period last year; this grant income was recorded as a reduction of research and development expense in each year.

There was operating income for the second quarter of \$196,000 compared with an operating loss of \$463,000 in the same period last year, which included a \$605,000 restructuring charge. The table on page 14 shows the favorable and unfavorable percentage change for each income statement line item due to the impact of foreign currency exchange rate movements and volume impacts. The 52% unfavorable change in operating income for the three month period to March 29, 2014 represents a reduction of \$241,000 in operating income compared to the three month period ended March 30, 2013, due to foreign currency changes. Excluding the impact of foreign currency, operating income would have been \$437,000, an increase of \$900,000 compared to the prior year period. This was mainly due to a weaker U.S. Dollar compared to the Euro and the British Pound than in the prior year period.

In the second quarter of 2014, interest expense was \$19,000; a decrease of \$7,000 compared to the prior year, due to the Company's U.K. bank overdraft facility being little used during the first half of 2014 and lower interest payable on the bank loan in the capacitor business.

The Company recorded income before income taxes of \$139,000 in the second quarter of 2014 compared to a loss before income taxes of \$576,000 in the same period last year. There was an income tax benefit of \$23,000 compared with a benefit of \$638,000, in the same period last year. The tax benefit recorded in the second quarter of 2014 reflects the significant variance in income tax rates in the jurisdictions in which the Company operates and the relative profit or loss made in each business.

There was net income for the quarter, after income tax benefit, of \$162,000 or \$0.05 per diluted share, compared to net income after tax of \$62,000, or income of \$0.02 per diluted share in the same quarter last year.

We have announced that we are considering raising additional equity capital to finance growth, including investment in our engineering and other technical resources. We may seek to generate growth organically, through the acquisition of other businesses, or both and we may commence these activities during the current quarter. Any such activity will incur additional cost, in both the near and longer term, which is likely to be material.

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Six months ended March 29, 2014 and March 30, 2013

The following table compares the first half year results by segment for the six months ended March 29, 2014 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) |          |        |
|--|------------------|----------------|-------------------------|----------|--------|
|  | March 29, 2014   | March 30, 2013 | Total                   | Currency | Volume |
| <b>Sales:</b>  |                  |                |                         |          |        |
| Controls - to external customers   | \$17,136         | \$13,783       | 24                      | 3        | 21     |
| Capacitors - to external customers   | 1,083            | 874            | 24                      | 5        | 19     |
| Capacitors - inter-segment   | 2                | 6              | (67 )                   | 2        | (69 )  |
| Capacitors - total   | 1,085            | 880            | 23                      | 5        | 18     |
| Total sales to external customers  | 18,219           | 14,657         | 24                      | 3        | 21     |
| <b>Gross Profit:</b>   |                  |                |                         |          |        |
| Controls   | 6,940            | 4,961          | 40                      | (4 )     | 44     |
| Capacitors   | 494              | 286            | 73                      | 7        | 67     |
| Total  | 7,434            | 5,247          | 42                      | (3 )     | 45     |
| <b>Selling, research and administrative expenses and restructuring charge:</b> |                  |                |                         |          |        |
| Controls   | (6,101 )         | (6,397 )       | 5                       | (3 )     | 8      |
| Capacitors   | (350 )           | (307 )         | (14 )                   | (4 )     | (10 )  |
| Unallocated corporate expense  | (77 )            | (191 )         | 59                      | -        | 59     |
| Total  | (6,528 )         | (6,895 )       | 5                       | (3 )     | 8      |
| <b>Operating income (loss):</b>  |                  |                |                         |          |        |
| Controls   | 839              | (1,436 )       | 158                     | (25 )    | 183    |
| Capacitors   | 144              | (21 )          | 786                     | 41       | 745    |
| Unallocated corporate expense  | (77 )            | (191 )         | 59                      | -        | 59     |
| Total  | 906              | (1,648 )       | 155                     | (21 )    | 176    |
| Other income and expense   | (158 )           | (338 )         | 53                      | 34       | 19     |
| Income (loss) before income tax  | 748              | (1,986 )       | 138                     | (12 )    | 150    |
| Income tax (provision) benefit   | (98 )            | 746            | (113)                   | -        | (113 ) |
| Net income (loss)  | \$650            | \$(1,240 )     | 152                     | (19 )    | 171    |

Sales in the six months ended March 29, 2014 were \$18,219,000, an increase of 3,562,000 or 24%, compared to the same period last year when sales were \$14,657,000. Foreign currency fluctuations increased reported sales in the first half year by \$430,000, or 3%, mainly due to a weaker U.S. Dollar compared to both the British Pound and the Euro than in the prior year period.

In the controls business segment, volumes shipped were higher in all geographic regions in which the Company operates; Europe, North America and the Far East were 17%, 16% and 71% higher, respectively, compared to the same period last year. The Company's traditional markets were 25% higher than the same period last year driven by higher sales to customers in aerial work platform and fork lift truck, as well as higher demand for on-road applications and aftermarket products. Sales increases in these sectors more than offset an 18% decrease in sales to mining customers. Sales in the four-wheel on-road sector were up substantially at 62% year-over-year, while sales in the two-wheel on-road sector were slightly lower than last year.

Volumes shipped in the capacitor business were 24% higher than the same period last year with higher demand from railway signaling customers and industrial equipment manufacturers.

Gross profit of \$7,434,000 was 40.8% of sales in the period compared to \$5,247,000, or 35.8%, in the comparable period in 2013; this increase in gross profit percentage was due to improved sales mix in both the controls business and the capacitor business and the impact of the cost savings implemented in the controls business in the second quarter last year.

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Selling, research and administrative expenses in the period were \$6,528,000, an increase of \$238,000 from the same period in 2013; the increase in operating expense year-on-year reflects increased investment in engineering and research and development and sales and marketing in response to the increased sales levels and customer demand compared to the prior year. Engineering and research and development expense as a percentage of total sales was 11% in the first half of 2014, compared with 14% in the same period last year. In addition, the Company recorded grant income of \$272,000 in the first half of 2014 compared to \$44,000 in the same period in the prior year; this grant income was recorded as a reduction of research and development expense in each period.

The Company recorded operating income in the first half of fiscal 2014 of \$906,000 compared with an operating loss in the first half of fiscal 2013 of \$1,648,000. The table on page 16 shows the favorable and unfavorable percentage change for each income statement line item due to the impact of foreign currency exchange rate movements and volume impacts. The 21% unfavorable change in operating income for the six month period to March 29, 2014 represents a reduction of \$352,000 in operating income compared to the six month period ended March 30, 2013, due to foreign currency changes. Excluding the impact of foreign currency, operating income would have been \$1,258,000, an increase of \$2,906,000, compared to the prior year period. This was mainly due to a weaker U.S. Dollar compared to the Euro and the British Pound than in the prior year period.

In the first half of 2014 the Company recorded an income tax charge of \$98,000, or 13.1% of income before income tax, compared to an income tax benefit of \$746,000, or 37.6% of the loss before income tax in the same period in 2013. The lower effective tax rate in 2014 reflects the significant variance in income tax rates in the jurisdictions in which we do business and the relative profit or loss made in each business in each period. In addition, there is a continuing impact of the year-on-year reduction in the corporate income tax rate in the U.K. and also the availability in the U.K. of favorable research and development tax credits, which further reduces our effective U.K. income tax rate.

The Company recorded net income for the first half of 2014 of \$650,000 or \$0.19 per diluted share compared to a net loss for the first half of 2013 of \$1,240,000 or \$0.37 per diluted share.

## Financial Condition

Cash balances at the end of the second quarter of 2014 were \$1,450,000 compared to \$2,062,000 on September 30, 2013, a reduction in cash of \$612,000 in the first six months of 2014.

Other receivables of \$883,000 at March 29, 2014 include \$558,000 of receivables in the Company's French subsidiary that have been reclassified from trade receivables. In January 2014 management was advised that SITL, a customer of the Company's French subsidiary and a manufacturer of on-road electric vehicles, had entered administration protection for a minimum period of six months. The Company has submitted a claim with the French court appointed administrator for the full amount of the receivable of \$558,000 and no resolution is expected for at least another month from the date of this filing. In late April 2014, the Commercial Court in Lyon gave Sevcon the option to recover from SITL the entire inventory of material represented by the receivable of \$558,000. The inventory concerned represents current saleable product and, in the opinion of management, could be sold by the Company's French subsidiary to alternative customers in a reasonable timescale. Due to the high level of uncertainty at this time, management has not assessed a reserve for an uncollectible amount, but any loss incurred may be up to the amount recorded at March 29, 2014, of \$558,000 less the value of the inventory that would be recovered from SITL should the Company exercise its option to do so.

In the first six months of 2014, operating activities used \$341,000 of cash. Excluding the impact of currency fluctuations, receivables increased by \$508,000, inventories increased by \$136,000 and prepaid expenses increased by \$530,000, all of which reduced cash during the period. Accounts payable increased by \$99,000 which increased cash in the period. Accrued expenses and accrued taxes decreased by \$167,000 and \$83,000, respectively, which reduced

cash in the period. The number of days sales in receivables increased in the first six months of 2014 by one day from 65 days at September 30, 2013 to 66 days at March 29, 2014. Capital expenditures in the first six months were \$249,000. Exchange rate changes increased reported cash by \$64,000 in the first six months of 2014.

The Company had a U.K. bank loan of \$53,000, of which \$49,000 was short-term and \$4,000 long-term debt at March 29, 2014. It has overdraft facilities in the United Kingdom amounting to \$1,495,000, which were unused as of March 29, 2014 and September 30, 2013. The overdraft facility of the U.K. capacitor subsidiary is secured by a legal charge over the property owned and occupied by that company. The overdraft facility of the U.K. controls subsidiary is secured by a legal charge over a property owned by that company. Both facilities were renewed in the third quarter of 2013 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.

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The Company's wholly owned subsidiary, Sevcon USA, Inc., has a \$3,500,000 secured revolving credit facility with RBS Citizens, National Association for working capital and general corporate purposes. The obligations under the revolving credit facility are guaranteed by the Company and are secured by all of the assets of Sevcon USA, Inc. and a pledge of all of the capital stock of Sevcon USA, Inc. The facility imposes customary limitations on Sevcon USA, Inc.'s ability to, among other things, pay dividends, make distributions, and incur additional indebtedness. Under the facility, Sevcon USA, Inc. must maintain, on a quarterly basis, a debt to tangible net worth ratio of no more than 2.40:1 and a debt service coverage ratio of no less than 1.25:1 for each rolling twelve-month period. Upon entering into the revolving credit facility, Sevcon USA, Inc. drew down \$1,700,000, which was the total amount outstanding at March 29, 2014. The revolving credit facility will expire on June 14, 2017 when all outstanding principal and unpaid interest will be due and payable in full.

There were no significant capital expenditure commitments at March 29, 2014. It is estimated that the Company will make contributions to its frozen U.K. and U.S. defined benefit pension plans of approximately \$695,000 in fiscal 2014. Should the Company suffer a material reduction in revenues in 2014 this commitment could adversely impact the Company's financial position.

The outlook continues to remain uncertain, given the continuing worldwide economic situation and in particular the low economic growth environment in Europe and North America and the continuing austerity measures in Europe. In the opinion of management, the Company's requirements for working capital to meet projected operational and capital spending at status quo levels 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. 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.

However, management has said that in order to increase the rate of growth and improve shareholder value we would need to increase our investment in engineering and other technical resources. We may do this organically, through the acquisition of other businesses, or both. In either case, we need to raise additional equity capital. Such capital may not be available to us at a reasonable cost or at all.

Item 3 Quantitative and Qualitative Disclosures about Market Risk.

As a smaller reporting company, the Company is not required to respond to this item. However, we are providing the following information about our foreign currency and interest rate risks to supplement the disclosures in Item 2.

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 2014, approximately 50% of the Company's sales were made in U.S. Dollars, 27% were made in British Pounds and 23% were made in Euros. Approximately 80% 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.



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The following table provides information about the Company's foreign currency accounts receivable, accounts payable and firmly committed sales contracts outstanding as of March 29, 2014. 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 March 29, 2014 are expected to mature based on the exchange rate of the relevant foreign currency to U.S. Dollars at March 29, 2014:

|   | Expected<br>maturity<br>or<br>transaction<br>date<br>Fiscal<br>2014 | (in<br>thousands<br>of dollars)<br>Expected<br>maturity<br>or<br>transaction<br>date<br>Fair<br>value<br>2014 |
|---|---|---|
| On balance sheet financial instruments: |   |   |
| In \$ U.S. Functional Currency          |   |   |
| Accounts receivable in British Pounds   | 1,337   | - 1,337   |
| Accounts receivable in Euros            | 2,363   | - 2,363   |
| Accounts payable in British Pounds      | 695   | - 695   |
| Accounts payable in Euros               | 2,937   | - 2,937   |
| Anticipated Transactions                |   |   |
| In \$ U.S. Functional Currency          |   |   |
| Firmly committed sales contracts        |   |   |
| In British Pounds                       | 1,381   | - 1,381   |
| In Euros                                | 1,968   | - 1,968   |

## 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. If the banking system or the fixed income or credit markets deteriorate or become volatile, the values and liquidity of these investments could be adversely affected. The Company did not have any surplus funds invested as of March 29, 2014.

At March 29, 2014, the Company had \$53,000 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 also had, at March 29, 2014, a \$3,500,000 secured revolving credit facility with RBS Citizens, National Association of which \$1,700,000 had been drawn down by the Company's U.S. controller business, Sevcon USA, Inc., and which was the total amount outstanding at that date. 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 March 29, 2014, 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.

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Item 1A Risk Factors

In addition to the market risk factors set forth in Part I, Item 1A of our 2013 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 have appeared to improve since 2010, economic instability remains, particularly in the Eurozone. 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.

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

The Company is increasingly involved in developing products for the on-road electric vehicle market. We have relationships with several customers that 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 51% of the Company's revenues in the first six months of 2014 and the largest customer accounted for 14% of revenues. Although we have had business relationships with some of these customers for many years, our relationships with on-road EV customers are newer and, in any event, there are no long-term contractual supply agreements in place with any customer. Accordingly our performance could be adversely affected by the loss of one or more of these key customers.

The Company's commitment to make defined benefit pension contributions could adversely impact its financial position.

It is estimated that the Company will make contributions to its frozen U.K. and U.S. defined benefit pension plans of approximately \$695,000 in fiscal 2014. Should the Company suffer a material reduction in revenues in 2014 this commitment could adversely impact the Company's financial position.

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.

The continuing debt crisis in the Eurozone may have a material adverse effect on our business and operating results, which could adversely affect our stock price.

There continues to be significant uncertainty about the stability of global credit and financial markets in light of the continuing debt crisis in certain European countries. A default or a withdrawal from the Eurozone by any of the countries involved, or the uncertainty alone, could cause the value of the Euro to deteriorate. This, or a change to a local currency, would reduce the purchasing power of affected European customers. We are unable to predict the likelihood of any of these events but, if any occurs, our business, financial position and results of operations could be materially and adversely affected.

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

The Company relies on single, or a small number of, 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.

Failure to comply with financial covenants in our loan agreement could adversely affect us.

As of March 29, 2014, the Company's subsidiary in the United States, Sevcon USA, Inc. had \$1,700,000 of outstanding indebtedness under a revolving credit facility with RBS Citizens, National Association. This indebtedness is secured by all of Sevcon USA, Inc.'s assets and a pledge of all the capital stock of Sevcon USA, Inc. The loan agreement includes financial covenants which require us to maintain compliance with certain financial ratios during the term of the agreement. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Financial Condition". Failure to comply with the financial covenants would be an event of default under the loan agreement that would give the lender the right to cease making additional advances, accelerate repayment of all sums due and take action to collect the monies owed to it, including foreclosing on its security interest, which would have a material adverse effect on the Company's financial condition.

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.

We may not be able to attract and retain the level of high quality engineering staff that we need to develop the new and improved products we need to be successful.

The Company needs sufficient highly qualified engineers and technicians to develop and test the products our customers require. This is an expensive and scarce resource. If we are unable to attract and retain the level of high quality engineering staff that we need for our new and improved products, we will lose business and our financial condition will be adversely affected.

We may not be able to raise the capital we would like to have to grow our business.

Growing organically or through acquisitions of other businesses is expensive. We are considering raising equity capital, either through a rights offering or otherwise. If we are not able to raise as much as would be needed to pursue all the opportunities available to us, we will have to cut back or delay development projects, which could have a material adverse effect on our results of operations and financial condition.

Businesses we acquire may not generate the revenue and earnings we anticipate and may otherwise adversely affect our operations and financial condition.

We are considering supplementing our growth by acquiring new businesses. If we do that, but we fail to successfully integrate and manage the businesses we acquire, or if an acquisition does not further our business strategy as we expected, our operating results and financial condition may be materially adversely affected. Business combinations also involve a number of risks and uncertainties that can have an adverse impact, including that:

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- the costs of acquiring and integrating another business may be materially greater than we anticipate; managing an acquired company’s technologies or lines of business or entering new markets where we have limited or no prior experience or where competitors may have stronger market positions may be more difficult than we anticipate;
- we may fail to achieve the expected return on our investments, which could adversely affect our business or operating results and potentially cause impairment to assets that we recorded as a part of an acquisition, including intangible assets and goodwill;
- the attention of our management and employees may be diverted;
- we may not be able to retain key personnel of an acquired business;
- we may assume unanticipated legal or financial liabilities;
- we may suffer significant increases in our interest expense, leverage and debt service requirements if we incur additional debt to pay for an acquisition; and
- our existing stockholders may be diluted and earnings per share may decrease if we were to issue a significant amount of equity securities in connection with an acquisition.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

Shares of common stock re-acquired in order to pay the withholding taxes due upon vesting of restricted stock awards during the three months ended March 29, 2014, were as follows:

| Period                                | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|---------------------------------------|----------------------------------|------------------------------|--|--|
| December 29, 2013 to January 25, 2014 | 8,223                            | \$ 7.70                      | -  | -  |
| January 26, 2014 to February 22, 2014 | -                                | -                            | -  | -  |
| February 23, 2014 to March 29, 2014   | -                                | -                            | -  | -  |
| Total                                 | 8,223                            | \$ 7.70                      | -  | -  |

Item 3 Defaults upon Senior Securities

None.

Item 4 Mine Safety Disclosures

Not Applicable.

Item 5 Other Information

None.

Item 6 Exhibits

See Exhibit Index immediately preceding the exhibits.

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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.

SEVCON, INC.

Date: May 13, 2014

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

INDEX OF EXHIBITS

Exhibit Description

- 3.1 Restated Certificate of Incorporation of the registrant (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K filed on June 7, 2011).
- 3.2 Amended and Restated By-laws of the registrant (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed on December 11, 2013).
- 10.1 Sevcon, Inc. 1996 Equity Incentive Plan, as amended (incorporated by reference to Appendix B to Proxy Statement filed on January 6, 2014).
- 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).
- 101 The following materials formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Statements of Operations (ii) Consolidated Statements of Comprehensive Income (Loss) (iii) Consolidated Balance Sheets (iv) Consolidated Statements of Cash Flows and (v) Notes to Consolidated Financial Statements. These materials are furnished and not “filed” herewith.