

SEVCON, INC.  
Form 10-Q  
August 10, 2015

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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 July 4, 2015

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 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

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(Do not check if a smaller reporting company)

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

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 August 10, 2015
Common stock, par value \$.10	3,694,122

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FOR THE QUARTER ENDED JULY 4, 2015  
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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)

	July 4, 2015	September 30, 2014
	(unaudited)	(derived from audited statements)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 8,548	\$ 11,238
Trade receivables, net of allowances for doubtful accounts of \$4 at July 4, 2015 and \$40 at September 30, 2014	7,764	6,694
Other receivables	564	183
Inventories	6,596	6,258
Prepaid expenses and other current assets	2,573	1,747
Total current assets	26,045	\$ 26,120
Property, plant and equipment, at cost:		
Land and improvements	22	23
Buildings and improvements	713	741
Equipment	11,621	10,918
	12,356	11,682
Less: accumulated depreciation	(9,702 )	(9,577 )
Net property, plant and equipment	2,654	2,105
Long-term deferred tax assets	3,315	3,910
Goodwill	1,435	1,435
Other-long term assets	417	397
Total assets	\$ 33,866	\$ 33,967
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long term debt	\$ -	\$ 28
Accounts payable	5,144	4,405
Accrued expenses and other current liabilities	1,968	1,836
Accrued and deferred taxes on income	-	7
Total current liabilities	7,112	6,276
Liability for pension benefits	8,674	9,529
Long term debt	500	1,700
Total liabilities	\$ 16,286	\$ 17,505

## Commitments and Contingencies (Note 16)

## Stockholders' equity:

Preferred stock, par value \$.10 per share - authorized - 1,000,000 shares; Outstanding, 452,374 shares at July 4, 2015 and 460,769 shares at September 30, 2014	45	46
Common stock, par value \$.10 per share - authorized 20,000,000 shares at July 4, 2015 and 8,000,000 at September 30, 2014; outstanding, 3,694,122 shares at July 4, 2015 and	369	359

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3,588,958 at September 30, 2014		
Premium paid in on common stock	6,507	6,040
Premium paid in on preferred stock	9,063	9,231
Retained earnings	10,448	9,495
Accumulated other comprehensive loss	(8,940 )	(8,829 )
Total Sevcon, Inc. and subsidiaries stockholders' equity	17,492	16,342
Non-controlling interest	88	120
Total stockholders' equity	17,580	16,462
Total liabilities and stockholders' equity	\$ 33,866	\$ 33,967

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

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## CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

Sevcon, Inc. and Subsidiaries

	(in thousands of dollars except per share data)			
	Three months ended		Nine months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Net sales	\$10,346	\$9,657	\$30,619	\$27,876
Cost of sales	(6,158 )	(6,081 )	(17,861 )	(16,866 )
Gross profit	4,188	3,576	12,758	11,010
Selling, general and administrative expenses	(2,551 )	(2,318 )	(7,630 )	(6,833 )
Research and development expenses	(1,376 )	(1,045 )	(3,911 )	(3,058 )
Operating income	261	213	1,217	1,119
Interest expense	(14 )	(18 )	(54 )	(53 )
Interest income	4	-	20	1
Foreign currency gain (loss)	(21 )	(7 )	258	(131 )
Change in fair value of foreign exchange contracts	132	-	(68 )	-
Income before income tax	362	188	1,373	936
Income tax (provision) benefit	(83 )	34	(188 )	(64 )
Net income	279	222	1,185	872
Net loss attributable to non-controlling interests	2	-	31	-
Net income attributable to Sevcon, Inc. and subsidiaries	281	222	1,216	872
Preference share dividends	(110 )	-	(335 )	-
Net income attributable to common stockholders	\$171	\$222	\$881	\$872
Net income per ordinary share – basic	\$0.04	\$0.07	\$0.25	\$0.26
Net income per ordinary share – diluted	\$0.04	\$0.06	\$0.25	\$0.25
Weighted average shares used in computation of earnings per share:				
Basic	3,486	3,406	3,459	3,394
Diluted	3,577	3,499	4,913	3,468

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

Sevcon, Inc. and Subsidiaries

	(in thousands of dollars)			
	Three months ended		Nine months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Net income attributable to Sevcon, Inc. and subsidiaries	\$281	222	\$1,216	\$872
Other comprehensive income (loss) net of tax:				
Foreign currency translation adjustment	174	22	(262 )	118
Defined benefit pension plans:				
Pension benefit plans adjustments during the period	66	57	198	170
Tax expense	(16 )	(13 )	(47 )	(39 )
	50	44	151	131

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Other comprehensive income (loss) net of tax	224	66	(111 )	249
Comprehensive income	\$505	\$288	\$1,105	\$1,121

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 dollars)	
	Nine months ended	
	July 4, 2015	June 28, 2014
Cash flow from operating activities:		
Net income	\$1,185	\$872
Adjustments to reconcile net income to net cash generated from (used by) operating activities:		
Depreciation	470	456
Unrealized loss on change in value of foreign exchange contracts	68	-
Stock-based compensation	406	225
Deferred tax provision	188	64
Increase (decrease) in cash resulting from changes in operating assets and liabilities:		
Trade receivables	(1,712 )	(306 )
Other receivables	(285 )	(494 )
Inventories	(517 )	(460 )
Prepaid expenses and other current assets	(321 )	(1,002 )
Accounts payable	836	566
Accrued expenses	159	(178 )
Accrued and deferred taxes on income	(99 )	(12 )
Liability for pension benefits	(308 )	(264 )
Net cash generated from (used by) operating activities	70	(533 )
Cash flow used by investing activities:		
Acquisition of property, plant and equipment	(1,088 )	(559 )
Investment in joint venture, net of cash acquired	-	322
Net cash used by investing activities	(1,088 )	(237 )
Cash flow used by financing activities:		
Repayments of long term debt	(1,728 )	(35 )
Proceeds of long term debt	500	-
Preferred stock dividends paid	(263 )	-
Purchase and retirement of common stock	(98 )	(63 )
Net cash used by financing activities	(1,589 )	(98 )
Effect of exchange rate changes on cash	(83 )	109
Net decrease in cash	(2,690 )	(759 )
Beginning balance - cash and cash equivalents	11,238	2,062
Ending balance - cash and cash equivalents	\$8,548	\$1,303
Supplemental disclosure of cash flow information:		
Cash paid for income taxes, net of refunds	86	12
Cash paid for interest	\$54	\$53
Conversion of preferred stock to common stock	\$169	\$-

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





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SEVCON, INC.

Notes to Consolidated Financial Statements – July 4, 2015

(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, and a joint venture located in China, the Company designs and sells, under the Sevcon name, 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, trucks, fork lift trucks, aerial lifts, mining vehicles, agricultural tractors and implements and other electrically powered vehicles and systems. 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.

Prior period balances in the consolidated statement of income have been reclassified to conform to the current period presentation of disclosing separately research and development expenses and selling, general and administrative expenses. In 2014 these expenses were disclosed together as Selling, research and administrative expenses

Accounting for wholly-owned subsidiaries

The accompanying consolidated financial statements include the accounts of the Company’s wholly-owned subsidiaries; Sevcon USA, Inc., Sevcon Ltd., Industrial Capacitors (Wrexham) Ltd., Sevcon SAS, Sevcon Asia Limited and Sevcon Japan KK, in accordance with the provisions required by the Consolidation Topic 810 of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”). All material intercompany transactions have been eliminated.

Accounting for joint-venture subsidiary

For the Company's less than wholly owned subsidiary, Sevcon New Energy Technology (Hubei) Company Limited, the Company first analyzes whether this joint venture subsidiary is a variable interest entity (a “VIE”) in accordance with ASC 810 and if so, whether the Company is the primary beneficiary requiring consolidation. A VIE is an entity that has (i) insufficient equity to permit it to finance its activities without additional subordinated financial support or (ii) equity holders that lack the characteristics of a controlling financial interest. VIEs are consolidated by the primary beneficiary, which is the entity that has both the power to direct the activities that most significantly impact the entity’s economic performance and the obligation to absorb losses or the right to receive benefits from the entity that potentially could be significant to the entity. Variable interests in a VIE are contractual, ownership, or other financial interests in a VIE that change with changes in the fair value of the VIE’s net assets. The Company continuously re-assesses (i) whether the entity is a VIE, and (ii) if the Company is the primary beneficiary of the VIE. If it is determined that the entity in which the Company holds its interest qualifies as a VIE and the Company is the primary beneficiary, it is consolidated.

Based on the Company's analysis for its 50% owned joint venture, the Company has determined that it is a VIE and that the Company is the primary beneficiary. While the Company owns 50% of the equity interest in this subsidiary, the other 50% is owned by a local unrelated third party, and the joint venture agreement with that third party provides the Company with greater voting rights. Accordingly, the Company consolidates its joint venture under the VIE rules

and reflects the third party's 50% interest in the consolidated financial statements as a non-controlling interest. The Company records this non-controlling interest at its initial fair value, adjusting the basis prospectively for their share of the respective consolidated investments' net income or loss or equity contributions and distributions. This non-controlling interest is not redeemable by the equity holders and is presented as part of permanent equity. Income and losses are allocated to the non-controlling interest holder based on its economic ownership percentage.

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 July 4, 2015 and the results of operations and cash flows for the three and nine month periods ended July 4, 2015. These unaudited interim financial statements should be read in conjunction with the 2014 annual consolidated financial statements and related notes included in the 2014 Sevcon, Inc. Annual Report filed on Form 10-K (the "2014 10-K"). Unless otherwise indicated, each reference to a year means the Company's fiscal year, which ends on September 30.

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The results of operations for the three and nine month periods ended July 4, 2015 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 2014 to the significant accounting policies followed by Sevcon, Inc.

(3) New accounting pronouncements

In May 2014, the FASB amended its guidance regarding revenue recognition and created a new Topic 606, "Revenue from Contracts with Customers". The objectives for creating Topic 606 were to remove inconsistencies and weaknesses in revenue recognition, provide a more robust framework for addressing revenue issues, provide more useful information to users of the financial statements through improved disclosure requirements, simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer, and improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve the core principle, an entity should apply the following steps: 1) identify the contract(s) with a customer; 2) identify the performance obligations in the contract; 3) determine the transaction price; 4) allocate the transaction price to the performance obligations in the contract; and 5) recognize revenue when (or as) the entity satisfies a performance obligation. For public entities, the amendments are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The amendments may be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the amendment recognized at the date of initial application. We are currently assessing the impact of adoption of this standard on our consolidated financial statements.

(4) Stock-based compensation plans

Under the Company's 1996 Equity Incentive Plan (the "Plan") there were 139,578 shares reserved and available for grant at July 4, 2015. There were 183,400 shares reserved and available for grant at June 28, 2014.

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.

There were no options outstanding or exercisable at July 4, 2015 or June 28, 2014, and there were no options granted or exercised in the three and nine month periods ended July 4, 2015 and June 28, 2014.

In December 2014, the Company granted 42,000 shares of restricted stock to eight employees, which will vest in two equal annual installments 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 on the date of grant was \$330,000 based on the fair market value of stock on the date of issue. This unvested compensation is being charged to income on a straight line basis over two years. The charge to income for this employee restricted stock in the first nine months of 2015 was \$82,000 and the subsequent charge will be approximately \$41,000 on a quarterly basis.

In December 2014, the Company granted 20,000 shares of restricted stock to three employees, which will vest in five equal annual installments 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 on the date of grant was \$139,000 based on the fair market value of stock on the date of issue. This 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 nine months of 2015 was \$14,000 and the subsequent charge will be approximately \$7,000 on a quarterly basis.

In February 2015, the Company granted 30,600 shares of restricted stock to nine non-employee directors, which will vest on the day before the 2016 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 \$225,000, 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 nine months of fiscal 2015 was \$75,000 and the subsequent charge will be approximately \$56,000 on a quarterly basis.

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A summary of restricted stock activity for the nine months ended July 4, 2015 is as follows:

	Number of shares of Restricted Stock	Weighted Average Grant-Date Fair Value
Non-vested balance as of September 30, 2014	168,600	\$ 5.27
Granted	92,600	\$ 7.68
Vested	(64,600 )	\$ 6.32
Non-vested balance as of July 4, 2015	196,600	\$ 6.07

Stock-based compensation expense was \$147,000 and \$406,000 for the three and nine month periods ended July 4, 2015 and \$98,000 and \$225,000 for the three and nine month periods ended June 28, 2014, respectively. At July 4, 2015, there was \$923,000 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 2.3 years.

## (5)Cash dividends

## Common stock dividends

The Board of Directors suspended common stock dividends to conserve cash during the global recession that began in 2009 and will consider whether to resume paying common stock dividends as conditions and the Company's operating results improve.

## Preferred Stock dividends

At July 4, 2015 there were 452,374 shares of Series A Convertible Preferred Stock issued and outstanding. The preferred stock, which has a stated value of \$24 per share, pays a 4% cumulative annual dividend semi-annually on October 15 and April 15 each year. Semi-annual dividends of \$42,000 and \$221,000 were paid on October 15, 2014 and April 15, 2015, respectively. The next semi-annual dividend will be paid on October 15, 2015.

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

Basic earnings per share is computed by dividing the net income or loss for the period attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. The computation of diluted earnings per share is similar to the computation of basic earnings per share, except that the numerator of net income attributable to common stockholders is adjusted by the effect of dilutive securities, including convertible preferred stock using the treasury stock method. The denominator is increased for the assumed exercise of dilutive options and other potentially dilutive securities, including convertible preferred stock and unvested restricted stock, using the treasury stock method, unless the effect is anti-dilutive.

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Basic and diluted net income per common share for the three and nine month periods ended July 4, 2015 and June 28, 2014 were calculated as follows:

	(in thousands of dollars except per share data)			
	Three months ended		Nine months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
<u>Numerator:</u>				
Net income attributable to common stockholders for computing net income per ordinary share - basic	\$171	\$222	\$881	\$872
Dividend eliminated upon assumed conversion of convertible preference shares	-	-	335	-
Net income attributable to common stockholders for computing net income per ordinary share - diluted	\$171	\$222	\$1,216	\$872
<u>Denominator:</u>				
Weighted average shares used in calculating net income per ordinary share - basic	3,486	3,406	3,459	3,394
Adjustment for assumed conversion of convertible preference shares	-	-	1,374	-
Adjustment for shares issuable upon vesting of restricted stock	91	93	80	74
Weighted average shares used in calculating net income per ordinary share - diluted	3,577	3,499	4,913	3,468
Net income per ordinary share - basic	\$0.04	\$0.07	\$0.25	\$0.26
Net income per ordinary share - diluted	\$0.04	\$0.06	\$0.25	\$0.25
No. of shares of convertible preference stock excluded during the period as such shares and related dividends would have the effect of increasing earnings per share	1,357	-	-	-

## (7) Segment information

The Company has two reportable segments: electronic controls and capacitors. The electronic controls segment produces 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 2014 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:

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	(in thousands of dollars)			
	Three months ended July 4, 2015			
	Controls	Capacitors	Corporate	Total
Sales to external customers	\$9,820	526	-	\$10,346
Inter-segment revenues	-	-	-	-
Operating income (loss)	342	5	(86 )	261
Identifiable assets, excluding goodwill	24,033	1,248	7,150	32,431
	Three months ended June 28, 2014			
	Controls	Capacitors	Corporate	Total
Sales to external customers	\$9,063	\$ 594	-	\$9,657
Inter-segment revenues	-	3	-	3
Operating income (loss)	194	108	(89 )	213
Identifiable assets, excluding goodwill	21,907	1,462	664	24,033
	Nine months ended July 4, 2015			
	Controls	Capacitors	Corporate	Total
Sales to external customers	\$29,000	1,619	-	\$30,619
Inter-segment revenues	-	3	-	3
Operating income	1,064	121	32	1,217
Identifiable assets, excluding goodwill	24,033	1,248	7,150	32,431
	Nine months ended June 28, 2014			
	Controls	Capacitors	Corporate	Total
Sales to external customers	\$26,199	\$ 1,677	-	\$27,876
Inter-segment revenues	-	5	-	5
Operating income (loss)	1,033	252	(166 )	1,119
Identifiable assets, excluding goodwill	21,907	1,462	664	24,033

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

	(in thousands of dollars)			
	Three Months ended		Nine Months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Electronic controls for zero emission and hybrid electric vehicles	\$7,445	\$6,591	\$19,746	\$19,730
Accessory and aftermarket products and services and engineering contracts	2,375	2,472	9,254	6,469
Total electronic controls segment revenues	\$9,820	\$9,063	\$29,000	\$26,199

## (8) Research and development

The cost of research and development programs is charged against income as incurred.

In recent years the Company has received several awards of research and development grants by public bodies established by the U.K. government to stimulate technology-enabled innovation.

In 2011, the Company was awarded a research and development grant by the UK 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 \$69,000 in the nine month period ended July 4, 2015, associated with research and development expense of \$245,000, in the same period. The Company recorded grant income of \$61,000 in the nine month period ended June 28, 2014, associated with research and development expense of \$180,000, in the same period.

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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 defrayed part of the research and development expense associated with this project over the period from July 2013 to March 31, 2015 and included a commitment to increase employment by twenty five heads at the Company's U.K. facility. The Company recorded grant income from this project of \$53,000 in the nine month period ended July 4 2015, associated with research and development expense of \$450,000, in the same period. The Company recorded grant income of \$339,000 in the nine month period ended June 28, 2014, associated with research and development expense of \$1,392,000, in the same period. The Company has received payment for the full amount of the awarded grant although there is an on-going obligation under the terms of the grant award to complete the job creation target by adding a further ten permanent positions at the Company's U.K. facility by the end of the second quarter of 2017.

In the third quarter of 2015 the Company was awarded a grant of approximately \$625,000 by the U.K. Regional Growth Fund, a U.K. government body. The grant is to develop an innovative range of low voltage motor controls which are designed to serve the emerging needs for on-road, automotive electrification. The grant will defray part of the research and development expense associated with this project over the period to March 31, 2017 and includes a commitment to create or safeguard a total of twenty jobs at the Company's U.K. facility over the period of the project. The Company recorded grant income from this project of \$37,000 in the three and nine month period ended July 4, 2015 associated with research and development expense of \$149,000.

The grant income in the first nine months of 2015 and 2014 was recorded as a reduction of research and development expense.

## (9) 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 the 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 nine month periods ended July 4, 2015 and June 28, 2014, respectively:

	(in thousands of dollars)			
	Three Months ended		Nine Months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Interest cost	\$308	\$330	\$928	\$973
Expected return on plan assets	(311)	(331)	(937)	(978)
Amortization of net loss	66	57	198	170
Net periodic benefit cost	63	56	189	165
Net cost of defined contribution plans	\$87	\$125	\$359	\$372
Net cost of all employee benefit plans	\$150	\$181	\$548	\$537

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The following table sets forth the movement in the liability for pension benefits in the nine month periods ended July 4, 2015 and June 28, 2014, respectively:

	(in thousands of dollars)	
	Nine Months ended	
	July 4, 2015	June 28, 2014
Liability for pension benefits at beginning of period	9,529	8,354
Interest cost	928	973
Expected return on plan assets	(937 )	(978 )
Plan contributions	(497 )	(429 )
Effect of exchange rate changes	(349 )	400
Balance at end of period	8,674	8,320

Amounts recognized in the balance sheet consist of:

	(in thousands of dollars)	
	July 4, 2015	September 30, 2014
Non-current liabilities	\$8,674	\$ 9,529

Amounts recognized in accumulated other comprehensive loss consist of:

	(in thousands of dollars)			
	Three Months ended		Nine Months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Actuarial loss, net of \$16 and \$47 tax benefit for the three and nine month periods, respectively, (2014: net of \$13 and \$39 tax benefit for the three and nine month periods, respectively)	\$50	\$ 44	\$151	\$131

Sevcon, Inc. contributed \$150,000 to its frozen U.S. defined benefit plan in the nine months ended July 4, 2015; it presently anticipates contributing a further \$50,000 to fund its U.S. plan in the remainder of fiscal 2015. In addition, employer contributions to the frozen U.K. defined benefit plan were \$347,000 in the first nine months and are estimated to total \$464,000 in 2015.

In the second quarter of 2015, the assets of the frozen U.K. defined benefit plan (the Sevcon Limited Pension Plan, “the Plan”) were reorganized by the trustees of the Plan. The trustees appointed Legal & General Investment Management to sell the Plan investments held in pooled funds previously managed by Standard Life Investments and a holding in the Absolute Return Fund managed by Ruffer LLP. The cash proceeds were subsequently invested as to 80% in an investment in Adept Strategy 9 Fund, a sub-fund of Adept Investment Management plc, a Qualifying Investor Alternative Investment Fund authorized and supervised by the Central Bank of Ireland. The other 20% of the cash

proceeds were invested in a range of Schroder Matching Plus Nominal and Index Linked Liability Driven Investment Swap Funds to match the profile of the Plan's liability cash flows.

The table below presents information about the Company's pension plan assets measured and recorded at fair value as of July 4, 2015 and indicates the fair value hierarchy of the inputs utilized by the Company to determine the fair values.

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	(in thousands of dollars)	
	Level 1*	Level 2**
	(Quoted prices in active markets)	(Significant observable inputs)
		Level 3*** (Unobservable inputs)
Mutual Funds		
Adept Strategy 9 Fund (a sub-fund of Adept Investment Management plc)	13,848	
Schroder Matching Plus Nominal and Index Linked Liability Driven Investment Swap Funds (funds Managed by Schroder Investment Management Limited)	3,437	
U.S. Equity Funds	376	
U.S. Mutual Funds and Fixed Income Funds	2,672	
Other Types of Investments	349	
Cash		
Total	3,397	17,285

The table below presents information about the Company's pension plan assets measured and recorded at fair value as of September 30, 2014:

	(in thousands of dollars)		
	Level 1*	Level 2**	Level 3***
	(Quoted prices in active markets)	(Significant observable inputs)	(Unobservable inputs)
Mutual Funds			
Standard Life Pension Global Absolute Returns Strategies Fund	7,187	-	-
Standard Life UK Indexed Linked Fund	1,856	-	-
Standard Life Long Corporate Bond Fund	1,785	-	-
CF Ruffer Absolute Return Fund	7,177	-	-
U.S. Mutual Funds	2,431	-	-
U.S. Exchange Traded Funds	348	-	-
Other Types of Investments			
Cash	333	-	-
Total	21,117	-	-

Level 1 inputs are quoted, unadjusted prices in active markets for identical assets or liabilities at the measurement date. The Company's pension plan financial assets in U.S. Equity Funds, Mutual Funds and Fixed Income Funds are Level 1 assets

\*\*Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The Company's pension plan financial assets held in the Adept Strategy 9

Fund and the Schroder investments are Level 2 assets. The Company uses the Net Asset Value to determine the fair value of underlying investments which (a) do not have readily determinable fair value; and (b) prepare their financial statements consistent with the measurement principles of an investment company. The Funds are not exchange traded. The Funds are not subject to any redemption notice periods or restrictions and can be redeemed on a daily basis. No gates or holdbacks or dealing suspensions are being applied to the Funds. The Funds are of perpetual duration.

\*\*\* Level 3 inputs are unobservable inputs for an asset or liability. 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)
2015	\$ 668
2016	707
2017	697
2018	695
2019	671
2020 – 2024	\$ 3,658

(10) Inventories

Inventories, net of reserve, were comprised of:

	(in thousands of dollars)	
	July 4, 2015	September 30, 2014
Raw materials	\$3,698	\$ 2,095
Work-in-process	90	102
Finished goods	2,808	4,061
	\$6,596	\$ 6,258

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(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 July 4, 2015 approximates fair value due to the short-term nature of these instruments.

(12) Derivative financial instruments

The Company uses derivative financial instruments to partially offset its market exposure to fluctuations in certain foreign currencies, principally the British Pound and the Euro, and does not enter into derivative contracts for speculative or trading purposes.

Derivative financial instruments designated as cash flow hedges

The Company documents at the inception of the transaction the relationship between the hedging instruments and the hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Company also documents its assessment, both at hedge inception and on an on-going basis, whether the derivative financial instruments that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in equity in other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statement of income within "Other income and expense".

Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss (for example, when foreign currency denominated financial liabilities are translated into their functional currencies). The gain or loss relating to the effective portion of cross currency swaps which hedge the effects of changes in foreign exchange rates are recognized in the consolidated statement of income within "foreign exchange differences". When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognized when the forecast transaction is ultimately recognized in the consolidated statement of income.

The company did not have any financial instruments designated as cash flow hedges at July 4, 2015 or June 28, 2014.

Derivative financial instruments not designated for hedging

The fair value of derivative financial instruments that do not meet the FASB authoritative guidance for hedge accounting are immediately recognized in the consolidated statement of income under "Other income and expense". The fair value of these derivatives are recorded under "Prepaid expenses and other current assets" for asset derivatives or "Accrued expenses and other current liabilities" for liability derivatives, in the consolidated balance sheet.

In the quarter ended April 4, 2015 the company entered into foreign currency forward contracts to hedge its exposure to future fluctuations in the exchange rate between the U.S. Dollar and the Euro. These contracts were intended to partially hedge the U.S. Dollar equivalent cost of the company's planned purchases of inventory denominated in Euros. The total gross amount of the outstanding forward contracts was \$2,009,000 at July 4, 2015 (\$0 at September 30, 2014). These agreements were recorded at fair value in the consolidated balance sheet, resulting in a net gain of \$132,000 and a net loss of \$68,000 in the consolidated statement of income for the three and nine month periods, respectively, ended July 4, 2015 (\$0 net gain or loss for the three and nine month periods ended June 28, 2014).





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The following table presents the fair values of the Company's derivative financial instruments for the following periods:

	(in thousands of dollars)	
	July 4, 2015	September 30, 2014
	Assets	Liabilities
Foreign currency contracts	- 68	-

The above liability derivative foreign currency contracts represent a Level 2 liability at July 4, 2015 in accordance with the fair value hierarchy described in Note 9.

## (13) Accrued expenses

Set out below is an analysis of other accrued expenses at July 4, 2015 and September 30, 2014, which shows separately any items in excess of 5% of total current liabilities:

	(in thousands of dollars)	
	July 4, 2015	September 30, 2014
Accrued compensation and related costs	\$ 886	\$ 1,062
Other accrued expenses	1,082	774
	\$ 1,968	\$ 1,836

## (14) 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 Months ended		Nine Months ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Warranty reserves at beginning of period	\$ 144	\$ 140	\$ 153	\$ 138
Decrease in beginning balance for warranty obligations settled during the period	-	(5 )	-	(49 )
Foreign currency translation adjustment	3	-	(9 )	2
Net increase in warranty reserves for products sold during the period and warranty expiration	-	8	3	52
Warranty reserves at end of period	\$ 147	\$ 143	\$ 147	\$ 143

## (15) Debt

The Company's wholly owned subsidiary, Sevcon USA, Inc., has a \$3,500,000 secured revolving credit facility with Citizens Bank, for working capital and general corporate purposes. The loan and security agreement will expire on June 14, 2017 when any outstanding principal and unpaid interest at that time 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. 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. Interest on the loan is payable monthly, and is calculated at a margin of 3.125% over LIBOR. The total amount outstanding under this secured revolving credit facility at July 4, 2015 was \$500,000 and at September 30, 2014 was \$1,700,000. The fair value of the debt at July 4, 2015 was \$500,000.

In July 2015, the Company's U.K. bank renewed the overdraft facilities of the Company's U.K. controls and capacitor subsidiaries. The Company's U.K. controls and capacitor subsidiaries each have multi-currency overdraft facilities which together total \$1,400,000 and which are secured by real estate owned by those companies. The renewal of the facilities is for a twelve month period although they can be withdrawn on demand by the bank. The facilities were unused at July 4, 2015 and at September 30, 2014.

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Annual principal payments on secured revolving credit facility at July 4, 2015 are as follows:

(in  
thousands  
of dollars)  
2017 \$ 500  
Total \$ 500

(16) Commitments and Contingencies

Sevcon, Inc. is involved in various legal proceedings in the ordinary course of business but believes that it is remote that the outcome will be material to operations.

The Company maintains a directors' retirement plan which provides for certain retirement benefits to non-employee directors. Effective January 1997 the plan was frozen and no further benefits are being accrued. While the cost of the plan has been fully charged to expense, the plan is not separately funded. The estimated maximum liability which has been recorded based on the cost of buying deferred annuities at July 4, 2015 and September 30, 2014 was \$156,000 and \$162,000, respectively.

Minimum rental commitments under all non-cancelable leases are as follows for the years ended September 30, 2015 - \$213,000; 2016 - \$205,000; 2017 - \$205,000; 2018 - \$208,000; 2019 - \$194,000 and \$3,405,000 thereafter.

The U.K. subsidiaries of the Company have given to RBS Nat West Bank a security interest in certain leasehold and freehold property assets as security for overdraft facilities of \$1,400,000. There were no amounts outstanding on the overdraft facilities at July 4, 2015 and at September 30, 2014. The obligations under a secured revolving credit facility entered into in 2011 by the U.S. subsidiary of the Company, are guaranteed by the Company and are secured by all of the assets and a pledge of all of the capital stock, of Sevcon USA, Inc. The total amount outstanding under this revolving credit facility was \$500,000 at July 4, 2015 and \$1,700,000 at September 30, 2014.

(17) 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.

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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 July 4, 2015, there have been no material changes to the critical accounting estimates described in the Company's 2014 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 THIRD QUARTER AND FIRST NINE MONTHS

## Results of Operations

Three months ended July 4, 2015 and June 28, 2014

The following table compares the results by segment for the three months ended July 4, 2015 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) % change due to:		
	July 4, 2015	June 28, 2014	Total	Currency	Volume
<b>Sales:</b>					
Controls - to external customers	\$9,820	\$9,063	8	(8)	) 16
Capacitors - to external customers	526	594	(11)	(9)	) (2)
Capacitors - inter-segment	-	3	(100)	(1)	) (99)
Capacitors – total	526	597	(12)	(9)	) (3)
Total sales to external customers	10,346	9,657	7	(8)	) 15
<b>Gross Profit:</b>					
Controls	3,958	3,284	20	6	) 14
Capacitors	230	292	(21)	(8)	) (13)
Total	4,188	3,576	17	4	) 13
<b>Selling, research and development and administrative expenses:</b>					
Controls	(3,616)	(3,090)	(17)	10	) (27)
Capacitors	(225)	(184)	(22)	13	) (35)
Unallocated corporate (expense) income	(86)	(89)	3	-	) 3
Total	(3,927)	(3,363)	(17)	10	) (27)
<b>Operating income:</b>					
Controls	342	194	76	252	) (176)
Capacitors	5	108	(95)	-	) (95)
Unallocated corporate income (expense)	(86)	(89)	3	-	) 3
Total	261	213	22	230	) (208)
Other income and expense	101	(25)	504	(46)	) 550
Income before income tax	362	188	93	254	) (161)
Income tax (provision) benefit	(83)	34	(344)	(445)	) 101
Net income	\$279	\$222	26	147	) (121)
Net loss attributable to non-controlling interests	2	-	100	-	) 100
Net income attributable to Sevcon, Inc. and subsidiaries	281	222	27	147	) (120)
Preference share dividends	(110)	-	100	-	) 100
Net income attributable to common stockholders	\$171	\$222	(23)	147	) (170)

The Company has, for the past three years, been investing in research and development of controls for electrification, which is the replacement of traditional internal combustion power sources and mechanical hydraulics with electric systems that improve efficiency, reduce emissions and lower overall cost in both off-road and on-road applications. This trend is driven by customers pursuing enhanced performance, lower operating costs and environmental compliance. The Company expects that, given the opportunities now presenting themselves, it will accelerate its investment in these areas, which could cause volatility in its earnings.

Sales in the third quarter of 2015 were \$10,346,000, compared to \$9,657,000 in the same quarter last year, a 7% increase year-on-year, despite weak conditions in some of our traditional off-road markets and unfavorable foreign exchange rates. Our growth was mainly driven by sales of our powertrain solutions for an expanding range of on-road electric and hybrid vehicle applications. This growth also reflected higher product volumes shipped to Seakeeper, a manufacturer of gyro stabilizers for marine applications. We also saw continued growth in demand for our next generation of products in other electrification applications such as hybridization in off-road sectors for improved performance and efficiency.

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Foreign exchange was a major influence on reported sales in the third quarter. Foreign currency fluctuations decreased reported sales by \$846,000, or 8%, mainly due to a stronger U.S. Dollar compared with the Euro and the British Pound than in the third quarter of fiscal 2014. Excluding the impact of foreign currency fluctuations, sales were 15% higher than in the prior-year period.

Sales in the Company's traditional off-road markets continued to reflect underlying macroeconomic trends. In addition, the weakness in global mining was joined, we believe temporarily, by the Chinese fork lift truck sector. The aerial work platform and airport ground support sectors were essentially flat in reported terms but volumes were up low double digits, year-over-year. Sales to the fork lift truck sector were down 20% year-on-year driven mainly by lower shipments to Chinese manufacturers. Our new line of high voltage, lower power inverters continue to open up applications for us in our emerging marine and agriculture markets as well as in construction equipment that involve higher battery voltages but have modest requirements for power.

In the on-road sector, sales for two wheel applications continue to be volatile from quarter to quarter; sales were 89% higher in the third quarter compared to the prior year, following flat year-over-year growth last quarter. In the four-wheel, on-road, sector, sales were 52% higher compared to the same period in 2014. This growth was mainly driven by two projects. The first with a U.S. manufacturer of electric vehicles, which is using our controllers for an all-electric passenger drivetrain designed for the Chinese market. The second on-road growth driver this quarter was the continued recognition of engineering services revenue and the overall progress we are making on the electrification project with a large German manufacturer of trucks, buses, engines and transportation solutions. This contract initially focused on a bespoke controller and motor subsystem we designed for heavy vehicle start/stop applications but in addition we are now supplying this customer and others with high voltage low power motor controllers for advanced heavy vehicle electrification projects.

The Company's Chinese joint venture continues to make good progress. This joint venture is initially targeting on-road electric and hybrid vehicle applications, marketing and selling principally to Chinese Tier 1 automotive suppliers. We anticipate the initial sales, related to pre-production orders and development proving, to lead to larger shipments. We expect to see good progress related to a number of projects in China coming to fruition later in 2015 and in future years. It is anticipated that the joint venture will enable the Company to develop relationships with additional new customers in China in what is rapidly becoming the world's largest market for two- and four-wheel electric vehicles.

In the controls business segment, sales were up 21% year-on-year in North America and sales in the Far East and Europe were lower by mid-single digits. In the capacitor business, excluding the adverse impact of foreign currency fluctuations, volumes shipped were 3% lower compared to the third quarter last year, largely reflecting lower demand from railway signaling customers.

The third quarter of 2015 marked a further quarter of year-on-year revenue growth. We believe that underlying demand is gathering strength in a number of our markets worldwide, and our business continues to benefit from having a low-cost, flexible manufacturing model. Due to the investments in engineering and sales over the past three years, we have an expanding pipeline of projects related to the global desire for electrification. Most important for the long term, the Company is gaining momentum in pursuit of these major growth opportunities, focusing not only on traction applications, but also on ancillary powertrain systems in motor vehicles and various industrial power applications. However, we cannot predict the timing or the magnitude of any potential resulting improvements in our revenues or margin from these projects and opportunities.

Gross profit of \$4,188,000 was 40% of sales in the third quarter, compared to \$3,576,000 or 37% 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 and the capacitor businesses including, in the controls business, the impact of revenues from engineering projects in Europe.

Selling, general and administrative expenses in the third quarter increased by \$564,000 from the third quarter of fiscal 2014, reflecting the additional cost of the Chinese joint venture in 2015 as well as increased investment in sales and marketing, including the hiring of new staff, compared to 2014. This investment in additional resources was in response to the higher order intake. In addition, the increased operating expense year on year reflected lower grant income in Q3 compared with the prior-year period. The Company recorded grant income of \$58,000 in the third quarter of 2015 compared with \$132,000 in the third quarter in 2014; this grant income was recorded as a reduction of research and development expense in each period. In addition, there has been continued investment in engineering and research and development resources, including the hiring of additional engineering staff in response to the increased pipeline of project work. Engineering and research and development expense as a percentage of total sales was 13.3% in the third quarter of fiscal 2015, compared with 10.8% in the same period last year.



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There was operating income for the third quarter of \$261,000 compared with \$213,000 in the same period last year. The table on page 17 shows the favorable and unfavorable percentage change for each income statement line item due to the impact of foreign currency exchange rate movements and changes in volumes sold. The \$48,000 recorded increase in operating income for the three month period to July 4, 2015 reflects a net decrease in operating income of \$181,000 from a combination of higher gross profit of \$725,000 and higher operating expenses of \$906,000, offset by an increase in operating profit of \$229,000, or 108%, due to favorable foreign currency fluctuations. The significant currency impact was due to a stronger U.S. Dollar compared to the Euro and the British Pound than in the prior year period, which both reduced the U.S. Dollar denominated value of inventory purchased in Euros and also reduced the reported U.S. Dollar value of operating expenses incurred in British Pounds and Euros.

Included in other income and expense of \$101,000 for the quarter was a foreign currency loss of \$21,000, compared with a foreign currency loss of \$7,000 in the third quarter of last year. This reflects the impact of the stronger U.S. Dollar compared with the Euro and the British Pound than in the third quarter of fiscal 2014, which reduced the Company's U.S. Dollar recorded cost of purchasing inventory in Euros.

The Company recorded in the third quarter a non-cash gain of \$132,000 arising from the adjustment to fair value at July 4, 2015, of foreign currency forward exchange contracts purchased to hedge exposure to currency fluctuations in exchange rate of the U.S. Dollar and the Euro. These contracts are derivative financial instruments that are not designated for hedge accounting and accordingly gains and losses arising from recording the agreements at fair value at the balance sheet date are recognized immediately in the consolidated statement of income.

The Company recorded income before income taxes of \$362,000 in the third quarter of 2015 compared to income before income taxes of \$188,000 in the same period last year. There was an income tax provision of \$83,000 compared with an income tax benefit of \$34,000, in the same period last year.

After adjusting for a \$2,000 net loss relating to the Company's non-controlling interest in the Chinese joint venture, there was net income attributable to the stockholders of Sevcon, Inc. of \$281,000 or \$0.04 per diluted share, compared to net income of \$222,000, and \$0.04 per diluted share, in the same quarter last year when the weighted average number of shares was lower due to the issue of convertible preferred stock in the fourth quarter of 2014. The Company recorded a preference share dividend of \$110,000 for the third fiscal quarter of 2015 compared with \$0 for the same quarter last year.

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Nine months ended July 4, 2015 and June 28, 2014

The following table compares the results by segment for the nine months ended July 4, 2015 with the same period in the prior year. The table shows the effect of currency and volume changes in percentage terms.

	Nine months ended		Favorable (unfavorable) % change due to:		
	July 4, 2015	June 28, 2014	Total	Currency	Volume
<b>Sales:</b>					
Controls - to external customers	\$29,000	\$26,199	11	(7 )	18
Capacitors - to external customers	1,619	1,677	(4 )	(7 )	3
Capacitors - inter-segment	3	5	(40 )	(4 )	(36 )
Capacitors - total	1,622	1,682	(4 )	(7 )	3
Total sales to external customers	30,619	27,876	10	(7 )	17
<b>Gross Profit:</b>					
Controls	12,012	10,224	17	5	12
Capacitors	746	786	(5 )	(7 )	2
Total	12,758	11,010	16	4	12
<b>Selling, research and development and administrative expenses:</b>					
Controls	(10,948)	(9,191 )	(19 )	8	(27 )
Capacitors	(625 )	(534 )	(17 )	9	(26 )
Unallocated corporate income (expense)	32	(166 )	119	-	119
Total	(11,541)	(9,891 )	17	8	(25 )
<b>Operating income:</b>					
Controls	1,064	1,033	3	118	(115 )
Capacitors	121	252	(52 )	(3 )	(49 )
Unallocated corporate income (expense)	32	(166 )	119	-	119
Total	1,217	1,119	9	109	(100 )
Other income and expense	156	(183 )	185	213	28
Income before income tax	1,373	936	47	171	124
Income tax provision	(188 )	(64 )	194	345	(151 )
Net income	\$1,185	\$872	36	159	(123 )
Net loss attributable to non-controlling Interests	31	-	100	-	100
Net income attributable to Sevcon, Inc. and subsidiaries	1,216	872	39	157	118
Preference share dividends	(335 )	-	100	-	100
Net income attributable to common stockholders	\$881	\$872	1	159	(158 )

Sales in the nine months ended July 4, 2015 were \$30,619,000, an increase of \$2,743,000 or 10%, compared to the same period last year when sales were \$27,876,000. Foreign currency fluctuations decreased reported sales in the first nine months of the year by \$1,946,000, or 7%, mainly due to a stronger 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 17% higher in Europe and 11% higher in North America but flat in the Far East compared to the same period last year. Sales to customers in the Company's traditional markets including aerial work platform, fork lift truck and mining applications were flat compared to the same period last year. In the on-road sector, sales increased 63%, which was driven by a combination of a 20% sales increase year-on-year in the two-wheel sector and an 89% increase in sales to the four-wheel sector. This growth in the four-wheel on-road sector was largely due to product shipments for bus and truck applications in Europe as well as the recognition of engineering revenues and progress made on an electrification project with a large German manufacturer of trucks,

buses, engines and transportation solutions. In addition there was a positive contribution to on-road sales in the first nine months of 2015 from the Company's Chinese joint venture which only began trading in the first quarter of this year.

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Volumes shipped in the capacitor business were 3% higher compared to the same period last year due to increased demand from railway signaling customers and industrial equipment manufacturers.

Gross profit of \$12,758,000 was 42% of sales in the period compared to \$11,010,000, or 39%, in the comparable period in 2014. This increase in gross profit percentage was due to improved sales mix in both the controls business and the capacitor business including, in the controls business, the impact of revenues from engineering projects in Europe.

Selling, general and administrative expenses in the first nine months of the year increased by \$1,650,000 compared with the same period in fiscal 2014, reflecting in part the additional cost of the Chinese joint venture in 2015 as well as increased investment in sales resources, including the hiring of new staff, compared to 2014. Research and development expense increased \$853,000 compared to the same period last year. This increase partly reflects the impact of reduced grant income recorded in the first nine months of 2015, which was \$239,000 lower than in the same period last year; this grant income was recorded as a reduction of research and development expense in each year. In addition, there has been increased investment in engineering and technical innovation, including the hiring of additional engineering staff in response to the increased pipeline of project work. Engineering and research and development expense as a percentage of total sales was 12.8% in the first nine months of fiscal 2015, compared with 11.0% in the same period last year.

The Company recorded operating income for the first nine months of 2015 of \$1,217,000 compared with \$1,119,000 in the same period last year. The table on page 20 shows the favorable and unfavorable percentage change for each income statement line item due to the impact of foreign currency exchange rate movements and changes in volumes sold. The \$98,000 recorded increase in operating income for the first nine months of fiscal 2015 reflects a net decrease in operating income of \$919,000, from a combination of higher gross profit of \$1,492,000 and higher operating expenses of \$2,411,000, offset by an increase in operating profit of \$1,017,000, due to favorable foreign currency fluctuations. The significant currency impact was due to a stronger U.S. Dollar compared to the Euro and the British Pound than in the prior year period, which both reduced the U.S. Dollar denominated value of inventory purchased in Euros and also reduced the reported U.S. Dollar value of operating expenses incurred in British Pounds and Euros.

Included in other income and expense of \$156,000 for first nine months of the year was a foreign currency gain of \$258,000, compared with a foreign currency loss of \$131,000 in the same period last year. This reflects the impact of the stronger U.S. Dollar compared with the Euro and the British Pound than in the same period in 2014, which reduced the Company's U.S. Dollar recorded cost of purchasing inventory in Euros.

The Company recorded in the first nine months of 2015 a non-cash charge of \$68,000 arising from the adjustment to fair value at July 4, 2015, of foreign currency forward exchange contracts purchased to hedge exposure to fluctuations in currency exchange rates of the U.S. Dollar and the Euro. These contracts are derivative financial instruments that are not designated for hedge accounting and accordingly gains and losses arising from recording the agreements at fair value at the balance sheet date are recognized immediately in the consolidated statement of income.

In the first nine months of 2015 the Company recorded an income tax charge of \$188,000, or 13.7% of income before income tax, compared to a charge of \$64,000, or 6.8% of income before income tax in the same period in 2014. The low effective tax rate in both periods 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.

After adjusting for a \$31,000 net loss relating to the Company's non-controlling interest in the Chinese joint venture, there was net income attributable to the stockholders of Sevcon, Inc. of \$1,216,000 or \$0.25 per diluted share. This compares to net income of \$872,000, and also \$0.25 per diluted share, in the same period last year when the weighted

average number of shares was lower due to the issue of convertible preferred stock in the fourth quarter of 2014. The Company recorded a preference share dividend of \$335,000 for the first nine months of the year of 2015 compared with \$0 for the same period last year.

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Financial Condition

Cash balances at the end of the third quarter of 2015 were \$8,548,000, compared to \$11,238,000 on September 30, 2014, a decrease in cash of \$2,690,000 in the first nine months of 2015. The reduction in cash included the net repayment of the \$1,200,000 borrowed from Citizens Bank, payment of \$664,000 of expense associated with the capital raise in September 2014, the payment of \$263,000 of preference share dividends and \$1,088,000 of capital expenditures in the period.

In the first nine months of 2015, operating activities generated \$70,000 of cash. Excluding the impact of currency fluctuations, trade and other receivables and inventories increased by \$1,997,000 and \$517,000, respectively, in the period, which reduced cash. Trade payables increased by \$836,000 which increased cash during the period. The number of days sales in receivables decreased by 3 days from 66 day's sales at September 30, 2014 to 63 days sales at July 4, 2015. Exchange rate changes decreased reported cash by \$84,000 in the first nine months of 2015.

In July 2015, the Company's U.K. bank renewed the overdraft facilities of the Company's U.K. controls and capacitor subsidiaries. The Company's U.K. controls and capacitor subsidiaries each have multi-currency overdraft facilities which together total \$1,400,000 and which are secured by real estate owned by those companies. 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 July 4, 2015 and at September 30, 2014. 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.

The Company's wholly owned subsidiary, Sevcon USA, Inc., has a \$3,500,000 secured revolving credit facility with Citizens Bank, for working capital and general corporate purposes. The loan and security agreement will expire on June 14, 2017 when any outstanding principal and unpaid interest at that time 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. 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. Interest on the loan is payable monthly, and is calculated at a margin of 3.125% over LIBOR. The total amount outstanding under this credit facility at July 4, 2015 was \$500,000 and at September 30, 2014 was \$1,700,000.

There were no significant capital expenditure commitments at July 4, 2015. It is estimated that the Company will make contributions to its U.K. and U.S. defined benefit pension plans of approximately \$664,000 in fiscal 2015; should the Company suffer a material reduction in revenues in 2015 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 certain parts of 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, and the U.S. 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, in order to further increase the rate of growth and improve shareholder value we would need to continue to increase our investment in engineering and other technical resources. We may do this organically or through

acquisitions of intellectual property and other products that could allow us to take advantage of customer opportunities more quickly than if we were limited to internal development. In either case, we may need to raise additional debt or equity capital. Such capital may not be available to us at a reasonable cost, or at all.

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## 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 and the majority of the Company's products are sourced in Europe. In the first nine months of 2015, approximately 52% of the Company's sales were made in U.S. Dollars, 24% were made in British Pounds and 24% were made in Euros. Approximately 85% 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, firmly committed sales contracts and derivative financial instruments outstanding as of July 4, 2015. 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, firmly committed sales contracts and forward exchange agreements as of July 4, 2015 are expected to mature based on the exchange rate of the relevant foreign currency to U.S. Dollars at July 4, 2015, and the notional amount (at contract exchange rates) and the weighted average contractual foreign currency exchange rates:

	Expected maturity or transaction date Fiscal 2015	(in thousands of dollars) Expected maturity or transaction date Fiscal 2016	Fair Value
On balance sheet financial instruments:			
In \$ U.S. Functional Currency			
Accounts receivable in British Pounds	1,453	-	1,453
Accounts receivable in Euros	2,028	-	2,028
Accounts payable in British Pounds	1,998	-	1,998
Accounts payable in Euros	3,890	-	3,890
Anticipated Transactions			
In \$ U.S. Functional Currency			
Firmly committed sales contracts			
In British Pounds	1,303	151	1,454
In Euros	1,945	11	1,956
Forward exchange agreements			
Sell U.S. Dollars for Euros	1,205	804	68
Average contractual exchange rate:			



U.S. Dollars = Euro	1.15	1.15	-
Amount recorded in accumulated			
Other comprehensive loss	-	-	-

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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 July 4, 2015.

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 July 4, 2015 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 2014 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, continuing instability in the European credit markets 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 43% of the Company's revenues in the first nine months of 2015 and the largest customer accounted for 10% 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.

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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.

Program development timescales are long and can be cancelled

In certain markets in which the Company operates, and in particular in the Company's new market sectors, non-recurring engineering development programs may take several years to complete and as result programs periodically reviewed by the customer can be cancelled at short notice. Cancellation of an engineering development program would potentially result in the Company not being nominated for the production phase of a project.

Production readiness is outside our control

In some new markets the Company's customer is responsible for ensuring that all of the components of their vehicle, working in unison, comply with local governmental regulations in order to achieve the necessary certification to proceed to volume production. Even though the Company's product performs to specification in all respects, the customer's vehicle may fail to satisfy overall the local governmental regulations due to the failure of one or more components supplied by other suppliers resulting in a project not proceeding to volume production.

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 \$664,000 in 2015 and at a similar level in subsequent years. Should the Company suffer a material reduction in revenues this commitment could adversely impact the Company's financial position.

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 four separate plants in Poland, Mexico, Malaysia 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.

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Management judgment in assessing inventory and warranty reserves may be less than required

Management uses its judgment and market information to assess levels of reserve required in certain areas including inventory and warranty. If actual future demand or market conditions are less favorable than those projected by management, or if product designs change more quickly than forecast, additional inventory reserves may be required. Should actual product failure rates and repair or replacement costs differ from management estimates, revisions to the estimated warranty reserve may be required and the Company's results may be materially adversely affected.

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

As of July 4, 2015, the Company's subsidiary in the United States, Sevcon USA, Inc. had a \$3,500,000 revolving credit facility with Citizens Bank; the total amount outstanding under this facility at July 4, 2015 was \$500,000. Any indebtedness under this facility 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 any monies owed to it, including foreclosing on its security interest, which could have a material adverse effect on the Company's financial condition.

Product defect may result in product recall

In the event that the Company discovers a product defect that impacts the safety or operation of its products, then a product recall may be necessary which could involve the Company in a substantial unanticipated expense significantly in excess of any reserve that had been made.

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.

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:

- 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.

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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 July 4, 2015, 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
April 5, 2015 to May 2, 2015	12,621	\$ 7.74	-	-
May 3, 2015 to May 30, 2015	-	-	-	-
May 31, 2015 to July 4, 2015	-	-	-	-
Total	12,621	\$ 7.74	-	-

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.

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: August 10, 2015 By: /s/ Paul N. Farquhar  
 Paul N. Farquhar  
 Chief Financial Officer (Principal Financial Officer)



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INDEX OF EXHIBITS

<u>Exhibit</u>	<u>Description</u>
3.1	Restated Certificate of Incorporation of the registrant (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed on February 3, 2015).
3.2	Amended and Restated By-laws of the registrant (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K filed on February 3, 2015).
<u>31.1</u>	Certification of Principal Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
<u>31.2</u>	Certification of Principal Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
<u>32.1</u>	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 Income (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.