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TECH OPS SEVCON INC  
Form 10-K  
December 27, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

(Mark One)

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended September 30, 2005 or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-9789

TECH/OPS SEVCON, INC.

(Exact name of registrant as specified in its charter)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)

04-2985631  
(I.R.S. Employer  
Identification Number)

155 NORTHBORO ROAD, SOUTHBOROUGH, Massachusetts 01772  
(Address of Principal Executive Offices) (Zip Code)

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

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

(Title of Each Class) (Name of Exchange on Which Registered)

Common stock, par value \$.10 PER SHARE American Stock Exchange

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934) Yes  No

Indicate by check mark whether the registrant is a shell company (as defined

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in Rule 12b-2 of the Securities Exchange Act of 1934) Yes [ ] No [X]

As of April 2, 2005, 3,172,051 common shares were outstanding, and the aggregate market value of the common shares (based upon the closing price on the American Stock Exchange) held by non-affiliates was \$15,010,000. As of December 14, 2005, 3,197,051 common shares were outstanding.

Documents incorporated by reference: Portions of the Proxy Statement for Annual Meeting of Stockholders to be held January 24, 2006 are incorporated by reference into Part III of this report.

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

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

### PART I

#### ITEM 1 BUSINESS

##### - General Description

Tech/Ops Sevcon, Inc. ("Tech/Ops Sevcon" or the "Company"), is a Delaware corporation organized on December 22, 1987 to carry on the electronic controls business previously performed by Tech/Ops, Inc. (Tech/Ops). Through wholly-owned subsidiaries located in the United States, England, France and South Korea the Company designs, manufactures, sells, and services, under the Sevcon name, solid-state products which control motor speed and acceleration for battery powered electric vehicles in a number of applications, primarily electric fork lift trucks, aerial lifts and underground coal-mining equipment. Through another subsidiary located in the United Kingdom, Tech/Ops Sevcon manufactures special metallized film capacitors for electronics applications. These capacitors are used as components in the power electronics, signaling and audio equipment markets. Approximately 95% of the Company's revenues are derived from the controls business, with the remainder derived from the capacitor business. The largest customer accounted for 16% of sales in fiscal 2005 compared to 11% in fiscal 2004 and 10% in fiscal 2003.

In fiscal 2005 sales were \$31,675,000, an increase of \$2,525,000, or 9%, compared to the previous year. Foreign currency fluctuations, principally the strength of the Euro and the British Pound compared to the US Dollar, accounted for an increase of \$640,000, or 2%, in reported sales. As a result, volumes grew by 7% compared to fiscal 2005. Most of the markets for the Company's products are cyclical and, although the aerial lift market has shown strong growth in fiscal 2005, performance in other markets has been generally poor with declines in the fork lift truck, airport ground support and capacitor markets. Research and development expense in fiscal 2005 was \$3,499,000 compared to \$3,952,000 in the prior year, a decrease of \$453,000, or 11%. This decrease was mainly due to a change in emphasis in the Company's advanced new product development program, using the Company's own engineering resources in place of external consultants, to complete the development of a new range of AC controls. Operating income in fiscal 2005 was \$999,000, compared to \$972,000 in the previous year. Net income was \$641,000, or \$.20 per diluted share, compared to \$611,000, or \$.19 per diluted share, last year. See Management's Discussion and Analysis of Financial Condition and Results of Operations for a more detailed analysis of fiscal 2005 performance.

##### - Marketing and sales

Sales are made primarily through a small full-time marketing staff. Sales in the United States were \$12,893,000, \$10,577,000 and \$8,141,000, in fiscal

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years 2005, 2004 and 2003, respectively, which accounted for approximately 41%, 36% and 35%, respectively, of total sales. Approximately 59% of sales are made to 10 manufacturers of electric vehicles in the United States, Europe and the Far East. Approximately 86% of the Company's sales are direct to end customers, with 14% made to the Company's international dealer network. See Note 7 to the Consolidated Financial Statements (Segment Information) in this Annual Report for an analysis of sales by segment, geographic location and major customers.

### - Patents

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

### - Backlog

Tech/Ops Sevcon's backlog at September 30, 2005 was \$4,957,000 compared to \$3,601,000 at September 2004, and \$2,682,000 at September 2003.

### - Raw materials

Tech/Ops Sevcon's products require a wide variety of components and materials. The Company has many sources for most of such components and materials and produces certain of these items internally. However, the Company relies on certain suppliers and subcontractors for all of its requirements for certain components, subassemblies, and finished products.

### - Competition

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

### - Research and development

Tech/Ops Sevcon's technological expertise is an important factor in its business. The Company regularly pursues product improvements to maintain its technical position. Research and development expenditures amounted to \$3,499,000 in 2005 compared to \$3,952,000 in 2004 and \$2,976,000 in 2003. The decrease in research and development spending of \$453,000, or 11%, in fiscal 2005 was principally due to lower consultancy costs on advanced new product development.

### - Environmental regulations

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

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## - Employees and labor relations

As of September 30, 2005, the Company employed 170 full-time employees, of whom 16 were in the United States, 140 were in the United Kingdom, 10 were in France, and 4 were in the Far East. Tech/Ops Sevcon believes its relations with its employees are good.

## ITEM 2 PROPERTIES

The US subsidiary of the Company leases approximately 13,500 square feet in Southborough, Mass., under a lease expiring in 2013. The United Kingdom electronic controls business of Tech/Ops Sevcon is carried on in two adjacent buildings owned by it located in Gateshead, England, containing 40,000 and 20,000 square feet of space respectively. The land on which these buildings stand are held on leases expiring in 2068 and 2121 respectively. The French subsidiary leases 5,000 square feet of space near Paris, France under a lease expiring in December 2009. The capacitor subsidiary of the Company owns a 9,000 square foot building, built in 1981, in Wrexham, Wales. The South Korean subsidiary of the Company leases approximately 1,000 square feet of office space in Incheon City, near Seoul, under a lease due to expire in 2007. The Company also leases approximately 600 square feet of office space in Tokyo, Japan under a lease due to expire in 2007. The properties and equipment of the Company are in good condition and, in the opinion of the management, are suitable and adequate for the Company's operations.

## ITEM 3 LEGAL PROCEEDINGS

The Company is involved in various legal proceedings arising in the ordinary course of business, but believes that these matters will be resolved without a material effect on its financial position.

## ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

## EXECUTIVE OFFICERS OF THE REGISTRANT

Name of Officer	Age	Position
Matthew Boyle	43	President & Chief Executive Officer
Paul A. McPartlin	60	Vice President, Treasurer & Chief Financial Officer

There are no family relationships between any director or executive officer and any other director or executive officer of the Company.

All officers serve until the next annual meeting and until their successors are elected and qualified. Mr. Boyle has been President and Chief Executive Officer since 1997 and was Vice President and Chief Operating Officer of the Company from 1996 to 1997. Mr. McPartlin has been Vice President and Chief Financial Officer of the Company since 1990 and Treasurer since 2000.

## PART II

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

The Common Stock of the Company is traded on the American Stock Exchange under the symbol TO. A summary of the market prices of, and dividends paid on, the Company's Common Stock is shown below. At December 14, 2005, there

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were approximately 250 shareholders of record.

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Year
-----					
2005 Quarters					
Cash dividends per share	\$ .03	\$ .03	\$ .03	\$ .03	\$ .12
-----					
Common stock price per					
share - High	\$ 6.60	\$ 7.15	\$ 6.30	\$ 6.10	\$ 7.15
- Low	5.65	6.20	5.10	5.70	5.10
-----					
2004 Quarters					
Cash dividends per share	\$ .03	\$ .03	\$ .03	\$ .03	\$ .12
-----					
Common stock price per					
share - High	\$ 6.28	\$ 6.75	\$ 6.70	\$ 6.40	\$ 6.75
- Low	5.05	5.40	5.75	5.80	5.05
-----					

### ITEM 6 SELECTED FINANCIAL DATA

A summary of selected financial data for the last five years is set out below:

For the Years ended September 30 (in thousands except per share data)

	2005	2004	2003	2002	2001
-----					
Net sales	\$31,675	\$29,150	\$23,113	\$21,872	\$27,002
Operating income	999	972	151	45	1,652
Net income	641	611	83	57	1,101
Basic income per share	\$ .21	\$ .20	\$ .03	\$ .02	\$ .35
Cash dividends per share	\$ .12	\$ .12	\$ .12	\$ .30	\$ .72
Average shares outstanding	3,125	3,125	3,125	3,117	3,110
Stockholders' investment	10,589	10,464	9,648	9,453	9,959
Total assets	\$16,446	\$16,608	\$13,784	\$13,521	\$15,750
-----					

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

#### FORWARD LOOKING STATEMENTS

Statements in this discussion and analysis about the Company's anticipated financial results and growth, as well as those about the development of its products and markets, are forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from those projected. These include the risks discussed under 'Risk Factors' below and throughout this Item 7.

#### NEW ACCOUNTING PRONOUNCEMENTS

The Company adopted the following new accounting pronouncements in fiscal 2005. See Note (1)P. to Consolidated Financial Statements for a more detailed description of these new accounting pronouncements.

Financial Accounting Standards Board (FASB) Staff Position 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes (SFAS No. 109), to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004" - Currently the Company does not expect this to have a material impact on its effective tax rate.

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FASB Staff Position 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004" - Currently the Company does not expect the potential repatriation to have a material impact on its effective tax rate.

SFAS #151, "Inventory Costs - an amendment of ARB No. 43" - The Company is evaluating the impact of this standard on its consolidated financial statements.

SFAS#123R, "Share-Based Payment" - Adoption was planned for the fourth quarter of fiscal 2005 but, following a change announced by the SEC on April 15, 2005, adoption has been deferred to the start of fiscal 2006. The Company will adopt the modified prospective application transition method. Under this method the Company expects to incur expense relating to previously issued stock options of approximately \$30,000 in fiscal 2006.  
CRITICAL ACCOUNTING ESTIMATES

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

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

### Bad Debts

The Company estimates an allowance for doubtful accounts based on known factors related to the credit risk of each customer and management's judgment about the customer's business. Ten customers account for approximately 59% of the Company's sales. At September 30, 2005 the allowance for bad debts amounted to \$144,000, which represented 2% of receivables.

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

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

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debt reserve to cover the remaining balances based on historical default percentages.

If the financial condition of any of the Company's customers is worse than estimated or were to deteriorate, resulting in an impairment of its ability to make payments, the Company's results may be adversely affected and additional allowances may be required. With the exception of a significant loss of \$562,000 in fiscal 2001 relating to one US customer, credit losses have not been significant in the past ten years.

### Inventories

Inventories are valued at the lower of cost or market. Inventory costs include materials, direct labor and manufacturing overhead, and are relieved from inventory on a first-in, first-out basis. The Company carries out a significant amount of customization of standard products and also designs and manufactures special products to meet the unique requirements of its customers. This results in a significant proportion of the Company's inventory being customer specific. The Company's reported financial condition includes a provision for estimated slow-moving and obsolete inventory that is based on a comparison of inventory levels with forecast future demand. Such demand is estimated based on many factors, including management judgments, relating to each customer's business and to economic conditions. The Company reviews in detail all significant inventory items with holdings in excess of estimated normal requirements. It also considers the likely impact of changing technology. It makes an estimate of the provision for slow moving and obsolete stock on an item-by-item basis based on a combination of likely usage based on forecast customer demand, potential sale or scrap value and possible alternative use. This provision represents the difference between original cost and market value at the end of the financial period. In cases where there is no estimated future use for the inventory item and there is no estimated scrap or resale value, a 100% provision is recorded. Where the Company estimates that only part of the total holding of an inventory item will not be used, or there is an estimated scrap, resale or alternate use value, then a proportionate provision is recorded. Once an item has been written down, it is not subsequently revalued upwards. The provision for slow moving and obsolete inventories at September 30, 2005 was \$803,000, or 18% of the original cost of gross inventory. At September 30, 2004 the provision was \$951,000, or 19% of gross inventory. If actual future demand or market conditions are less favorable than those projected by management, or if product designs change more quickly than forecast, additional inventory write-downs may be required, which may have a material adverse impact on reported results

### Warranty Costs

The Company provides for the estimated cost of product warranties at the time revenue is recognized. While the Company engages in product quality programs and processes, the Company's warranty obligation is affected by product failure rates and repair or replacement costs incurred in correcting a product failure. Accordingly, the provision for warranty costs is based upon anticipated in-warranty failure rates and estimated costs of repair or replacement. Anticipating product failure rates involves making difficult judgments about the likelihood of defects in materials, design and manufacturing errors, and other factors that are based in part on historical failure rates and trends, but also on management's expertise in engineering and manufacturing. Estimated repair and replacement costs are affected by varying component and labor costs. Should actual product failure rates and repair or replacement costs differ from estimates, revisions to the estimated warranty liability may be required and the Company's results may be materially adversely affected. In the event that the Company discovers a product defect that impacts the safety of its products, then a product



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recall may be necessary, which could involve the Company in substantial unanticipated expense significantly in excess of the reserve. There were no significant safety related product recalls during the past three fiscal years.

### Goodwill Impairment

The Company carries out an annual assessment to determine if the goodwill relating to the controls business amounting to \$1,435,000 has been impaired, in accordance with the requirements of SFAS #142. In fiscal 2004 the Company retained an investment banking firm specializing in valuations to assist the Company in performing this impairment assessment. The assessment was based on three separate methods of valuing the controls business based on expected free cash flows, the market price of the Company's stock and an analysis of precedent transactions. These estimates require estimates of future revenues, profits, capital expenditures and working capital requirements which are based on evaluation of historical trends, current budgets, operating plans and industry data. Based on all of these valuation methods the conclusion was that the goodwill had not been impaired. Management updated the analysis in 2005 using similar methodologies and again concluded that the goodwill had not been impaired. If, in future periods, the Company's results of operations, cash flows or the market price of the Company's stock were to decrease significantly then it may be necessary to record an impairment charge relating to goodwill of up to \$1,435,000.

### Pension Plan Assumptions

The Company makes a number of assumptions relating to its pension plans in order to measure the financial position of the plans and the net periodic benefit cost. The most significant assumptions relate to the discount rate, the expected long term return on plan assets and the rate of future compensation increase. If these assumptions prove to be incorrect then the Company may need to record additional expense relating to the pension plans which could have a material effect on the Company's results of operations. The Company's pension plans are significant relative to the size of the Company. Pension plan assets were \$14,210,000 at September 30, 2005 and the total assets of the Company were \$16,446,000. Although the plan assets are not included in the assets of the Company they are 86% of size of the Company's total assets. If, as a result of changes in assumptions, the accumulated benefit obligation of either of its US or UK plans were to exceed the fair value of assets of that plan, then an adjustment to record this additional liability and corresponding decrease in stockholders' equity would be necessary, which could have a material effect on the Company's financial position. At September 30, 2005 a decrease in the assumed discount rate of 0.25% would result in the Company recording a minimum liability of approximately \$725,000 relating to its UK plan, but no additional liability would be recognized in the smaller US plan.

### RISK FACTORS

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

Capital goods markets are cyclical

The Company's customers are mainly manufacturers of capital goods such as fork lift trucks, aerial lifts and railway signaling equipment. These markets are cyclical and are currently showing modest growth, but demand in these markets could decrease or customers could decide to purchase alternative products. In this event the Company's sales could decrease below its current break-even point and there is no certainty that the Company

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would be able to decrease overhead expenses to enable it to operate profitably.

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

The Company relies on certain suppliers and sub-contractors for all of its requirements for certain 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-contractor's buildings would hurt results

In the controller business the majority of product is produced in a single plant in England and uses sub-assemblies sourced from a sub-contractor with single plant in Poland. 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.

### A) Results of Operations

2005 compared to 2004

The following table compares results, for both the controls and capacitor segments, for fiscal 2005 with the prior year, showing separately the percentage variances due to currency and volume / other.

	2005	2004	% change due to:		
			Total	Currency	Volume/ other
-----					
Sales					
Controls - to external customers	\$30,009	\$27,101	11%	2%	9%
-----					
Capacitors- to external customers	1,666	2,049	-19%	2%	-21%
Capacitors - inter-segment	199	218	-9%	2%	-11%
-----					
Capacitors - total	1,865	2,267	-18%	2%	-20%
-----					
Total sales to external customers	31,675	29,150	9%	2%	7%
-----					
Gross Profit					
Controls	11,259	10,546	7%	-1%	8%
Capacitors	777	999	-22%	2%	-24%
-----					
Total	12,036	11,545	4%	-1%	5%
-----					
Selling research and administrative expenses					
Controls	9,916	9,572	4%	1%	3%
Capacitors	745	704	6%	2%	4%

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Unallocated corporate expense	376	297	27%	0%	27%
-----					
Total	11,037	10,573	4%	2%	2%
-----					
Operating income					
Controls	1,343	974	38%	-25%	63%
Capacitors	32	295	-89%	1%	-90%
Unallocated corporate expense	(376)	(297)	27%	0%	27%
-----					
Total	999	972	3%	-24%	27%
-----					
Other income and expense	(48)	(54)	-11%	-56%	45%
-----					
Income before income taxes	951	918	4%	-23%	27%
Income taxes	(310)	(307)	1%	-22%	23%
-----					
Net Income	\$ 641	\$ 611	5%	-23%	28%
-----					

In fiscal 2005 sales increased by \$2,525,000, or 9%, to \$31,675,000. Because these foreign sales were denominated in currencies other than the US Dollar, principally the Euro and the British Pound, they were subject to fluctuation when translated into US Dollars. The Dollar weakened compared to the British Pound in 2005 and the net effect of these changes in average foreign currency exchange rates was devaluation in the average exchange rate of the Dollar compared to the British pound of 3%. As a result, foreign currency fluctuations accounted for a 2% increase in reported sales, while volumes were 7% higher than the previous year.

In the controls business segment revenues were 11% higher than in fiscal 2004, including a 2% increase due to foreign currency fluctuations and a 9% increase in volumes shipped. In the United States controller business, sales were \$12,893,000 compared to \$10,577,000 in 2004, an increase of 22%. Sales volumes in the foreign controller businesses improved by 4% compared to last year. In the aerial lift market volumes were 45% ahead of the prior year and volumes also increased in the mining and other electric vehicle markets. Volumes in the fork lift truck and airport ground support markets declined compared to fiscal 2004.

In the capacitor business segment sales were down by \$383,000, or 19%. Due to difficult market conditions, particularly in specialist audio and railway signaling markets for capacitors, volumes were down by 21% compared to last year, but were partially offset by positive foreign currency fluctuations.

Cost of sales was \$19,639,000 compared to \$17,605,000 in fiscal 2004, an increase of \$2,034,000, or 12%. Approximately 80% of this cost of sales was denominated in British pounds. As a result foreign currency fluctuations increased cost of sales by \$720,000, or 4%. The remaining 8% increase in cost of sales was mainly due to higher volumes. Sales mix was adverse, with volume gains concentrated in the lower than average margin aerial lift market and sales decreases in some of the more profitable market segments. Within each major market segment a year-to-year comparison revealed improved percentage margins.

Gross profit was \$12,036,000, or 38.0% of sales, compared to \$11,545,000, or 39.6% of sales in fiscal 2004. Foreign currency fluctuations adversely impacted the gross profit percentage by 0.5% with adverse sales mix the main cause of the remaining 1.1% decrease in the gross profit percentage. This was offset slightly by the positive margin impact of a refined calculation

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of overheads in inventory in connection with the implementation of a new ERP computer system. In the controls segment gross profit of \$11,259,000 was 7% ahead of last year, and after adjusting for currency fluctuations increased by 8% compared to an increase in volumes of 9%. In the capacitor segment gross profit was \$777,000, a decrease of \$222,000, or 22% compared to fiscal 2004. Capacitor business gross profit was 41.7% of sales in fiscal 2005 compared to 44.1% of sales in the prior year. Lower volumes, foreign exchange fluctuations and sales mix all contributed to decrease the capacitor segment gross profit percentage.

Selling, research and administrative expenses (operating expenses) were \$11,037,000, an increase of \$464,000, or 4%, compared to fiscal 2004. Foreign currency fluctuations increased reported operating expenses by \$210,000, or 2%. Excluding the currency impact operating expenses increased by \$254,000. In fiscal 2005 the Company reduced its spending on engineering consultancy by \$915,000, as development of advanced new products was completed and these products moved into the testing and customer prototyping phases. To support these new product activities internal engineering resources were increased resulting in higher spending on in-house engineering of \$379,000, excluding the impact of currency fluctuations. Spending on sales and marketing resources in fiscal 2005, mainly to support the introduction of these new products, increased by \$450,000, before the impact of currency fluctuations. Included in administrative expense was a charge of \$87,000 relating to restricted stock granted to employees and directors in fiscal 2005. An analysis of the year-to-year change in selling, research and administrative expenses is set out below:

Selling, research and administrative expenses	(in thousands of dollars)
<hr/>	
Reported expense in fiscal 2005	\$ 11,037
Reported expense in fiscal 2004	10,573
<hr/>	
Increase in expense	464
<hr/>	
Increase (decrease) due to:	
Effect of exchange rate changes	210
Lower engineering consultancy costs in fiscal 2005, net of currency effect	(915)
Additional internal engineering expense, net of currency effect	379
Additional sales and marketing expense, net of currency effect	450
Charge for restricted stock grants in fiscal 2005	87
Other increases in operating expense - net,	253
<hr/>	
Total increase in selling research and administrative expenses in fiscal 2005	464
<hr/>	

Operating income was \$999,000 compared to \$972,000 in fiscal 2004, an increase of \$27,000. Foreign currency fluctuations adversely impacted operating income by \$240,000 in fiscal 2005. Excluding the currency effect, operating income increased by 27% compared to fiscal 2004. In the controller business, and excluding the currency impact, operating income was 63% ahead of fiscal 2004. Capacitor business operating income declined from \$295,000 to \$32,000, mainly due to a 20% decrease in volumes.

Other expense was \$48,000 in fiscal 2005 compared to \$54,000 in the previous year. Interest expense increased by \$27,000 to \$56,000 and there was a foreign currency gain of \$4,000 compared to a foreign currency loss of \$26,000 in 2004.

Income before income taxes was \$ 951,000 compared to \$918,000 in 2004. Foreign currency fluctuations adversely impacted pre tax income by \$240,000

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in fiscal 2005. Before the effect of currency fluctuations pre-tax income was 26% ahead of the prior year. Income taxes were 32.6% of pre-tax income compared to 33.4% in fiscal 2004. The lower average tax rate was mainly due to a reduction in the corporate tax rate in France. Net income was \$641,000, an increase of \$30,000 compared to last year. Basic income per share was \$.21 per share and diluted income per share was \$.20 per share. Both basic and diluted income per share were \$.01 per share ahead of fiscal 2004.

2004 compared to 2003

The following table compares results for fiscal 2004 with the prior year showing separately the percentage variances due to currency and volume / other. The results are shown for both the controls and capacitor business segments.

	2004	2003	% change due to:		
			Total	Currency	Volume/ other
-----					
Sales					
Controls - to external customers	\$27,101	\$20,730	31%	9%	22%
-----					
Capacitors- to external customers	2,049	2,383	-14%	10%	-24%
Capacitors - inter-segment	218	326	-33%	7%	-40%
-----					
Capacitors - total	2,267	2,709	-16%	10%	-26%
-----					
Total sales to external customers	29,150	23,113	26%	9%	17%
-----					
Gross Profit					
Controls	10,546	7,510	40%	3%	37%
Capacitors	999	1,295	-23%	8%	-31%
-----					
Total	11,545	8,805	31%	4%	27%
-----					
Selling research and administrative expenses					
Controls	9,572	7,563	27%	9%	18%
Capacitors	704	819	-14%	8%	-22%
Unallocated corporate expense	297	272	9%	0%	9%
-----					
Total	10,573	8,654	22%	8%	14%
-----					
Operating income					
Controls	974	(53)	1938%	-830%	2768%
Capacitors	295	476	-38%	8%	-46%
Unallocated corporate expense	(297)	(272)	9%	0%	9%
-----					
Total	972	151	544%	-265%	809%
-----					
Other income and expense	(54)	(23)	135%	248%	-113%
-----					
Income before income taxes	918	128	617%	-357%	974%
Income taxes	(307)	(45)	582%	-337%	919%

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Net Income	\$	611	\$	83	636%	-368%	1004%
------------	----	-----	----	----	------	-------	-------

In fiscal 2004, sales were \$29,150,000 compared to \$23,113,000 in 2003, an increase of 26%. Revenues in the United States were \$10,577,000, a volume increase of \$2,436,000, or 30%, compared to \$8,141,000 in fiscal 2003. In Europe and the Far East revenues of \$18,573,000 were \$3,601,000, or 24%, higher than the revenues of \$14,972,000 reported in the prior fiscal year. Because these foreign sales were denominated in currencies other than the US Dollar, principally the Euro and the British Pound, they were subject to fluctuation when translated into US Dollars. The Dollar weakened compared to both the Euro and the British Pound in 2004 and the net effect of these changes in average foreign currency exchange rates was a devaluation of the Dollar of 12%. Fiscal 2004 sales increased by \$2,027,000, or 9%, due to the impact of exchange rates on reported sales in foreign currencies. Therefore, shipment volumes in foreign markets were ahead of fiscal 2003 by \$1,574,000, or 11%. On a global basis volumes were \$4,010,000, or 17%, higher than in the prior fiscal year.

In the controls business segment sales were \$27,101,000, compared to \$20,730,000 the prior fiscal year, an increase in reported revenues of \$6,371,000, or 31%. Foreign currency changes increased reported controls segment revenues by \$1,791,000, or 9%. Therefore, shipment volumes in the controls business segment increased by \$4,580,000, or 22%. In the fork lift truck market, the largest end user market for the controls business, sales volumes decreased by 6% compared to the prior fiscal year mainly due to business decreases in the United States. Aerial lift volumes grew by 125% compared to the prior year with new business gains in the USA, the Far East and Europe. Volumes in the airport ground support market were ahead by 61%, with this market showing some recovery from the depressed conditions of the previous two years. Sales into the mining equipment end user market in the United States grew by 41% due to increased demand for coal. Sales into other electric vehicle markets, such as burden carriers, neighborhood electric vehicles and sweepers, increased by 26% compared to fiscal 2003.

In the capacitor business segment sales were \$2,049,000 compared to \$2,383,000 in the prior fiscal year, a decrease of \$334,000, or 14%. The change in the exchange rate of the British Pound compared to the US Dollar increased sales measured in Dollars by \$236,000, or 10%, compared to the prior fiscal year, therefore capacitor shipment volumes were down by \$570,000, or 24%. This decrease in volumes was due to both a change in raw material technology resulting in lower selling prices and decreased demand in both the railway signaling and professional high-end audio equipment end markets.

Cost of sales was \$17,605,000, compared to \$14,308,000 in fiscal 2003 an increase of \$3,297,000 compared to the prior fiscal year. The 23% increase in cost of sales was mainly due to higher volumes and foreign currency fluctuations and compares to an increase in sales of \$6,037,000, or 26%. Gross profit in fiscal 2004 was \$11,545,000, or 39.6% of sales, compared to \$8,805,000, or 38.1%, in the previous year. Foreign currency fluctuations increased reported gross profit by \$310,000 compared to the prior year. Excluding the effects of foreign currency changes, gross profit increased by \$2,430,000 and gross profit before currency changes was 38.5% of sales, an increase of 1.5% compared to fiscal 2003 due to both increased volumes and manufacturing unit cost efficiencies.

Selling, research and administrative expenses (operating expenses) were \$10,573,000 compared to \$8,654,000 the prior fiscal year, an increase of \$1,919,000, or 22%. Foreign currency fluctuations resulted in an increase in reported operating expenses of \$721,000, or 8%. Adjusting for the effects of

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foreign currencies operating expenses increased by \$1,198,000, or 14%. In fiscal 2004 the Company incurred consultancy costs of \$1,179,000 related to accelerated new product engineering, which compares to \$915,000 in the prior year. In the third quarter of fiscal 2004 the major portion of this consultancy work was completed. During fiscal 2004 the Company increased its internal engineering resources to support both increased levels of sales in 2004 and the introduction of advanced new products. In the second half of fiscal 2004 the Company strengthened its sales and marketing activities with the appointment of a new manager of worldwide sales and marketing for the controls business, in preparation for the launch of the advanced new product range. An analysis of the year-to-year change in selling, research and administrative expenses is set out below:

Selling, research and administrative expenses	(in thousands of dollars)
<hr/>	
Reported expense in fiscal 2004	\$ 10,573
Reported expense in fiscal 2003	8,654
<hr/>	
Increase in expense	1,919
<hr/>	
Increase (decrease) due to:	
Effect of exchange rate changes	721
Additional engineering consultancy costs in fiscal 2004, net of currency effect	139
Additional internal engineering expense, net of currency effect	487
Additional sales and marketing expense, net of currency effect	370
Other increases in operating expense - net,	202
<hr/>	
Total increase in selling research and administrative expenses in fiscal 2004	1,919
<hr/>	

Operating income in fiscal 2004 was \$972,000 compared to \$151,000 in fiscal 2003, an increase of \$821,000. Foreign currency changes resulted in a \$411,000 decrease in operating income; therefore there was a year-to-year improvement in operating income of \$1,232,000 before the impact of currencies. This improvement in operating income before the currency impact was mainly due to a 17% increase in shipment volumes and improved gross profit percentage, partly offset by higher operating expenses.

Interest expense in fiscal 2004 was \$29,000 compared to \$57,000 in the prior year, due to decreased short-term borrowing in Europe. Interest income was \$1,000 compared to \$2,000 in the prior year, due to lower cash balances. Other expense, mainly due to foreign currency losses, was \$26,000 compared to other income of \$32,000 in fiscal 2003.

Income before income taxes was \$918,000 in fiscal 2004, an increase of \$790,000 compared to the previous year. Income taxes were 33.4% of pre-tax income in fiscal 2004 compared to 35.2% in fiscal 2003. The lower tax rate was due to most of the income in fiscal 2004 arising in Europe, where average tax rates are lower. Net income in fiscal 2004 was \$611,000, compared to \$83,000 in the prior fiscal year. In fiscal 2004 basic net income per share was \$.20 and diluted net income per share was \$.19, a significant improvement compared to the prior fiscal year, when both basic and diluted net income per share were \$.03.

### B) Liquidity and Capital Resources

The Company's cash flow from operating activities for fiscal 2005 was \$1,324,000 compared to \$1,071,000 in the prior fiscal year. Acquisitions of property, plant and equipment amounted to \$571,000 compared to \$628,000 in fiscal 2004. Quarterly dividend payments were at the rate of \$.03 per share

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throughout both fiscal 2005 and 2004. In fiscal 2005 dividend payments amounted to \$379,000 per year compared to \$375,000 in 2004. Exchange rate changes decreased cash by \$149,000 in fiscal 2005 compared to an increase of \$313,000 last year. In fiscal 2005 cash balances increased by \$225,000, compared to an increase of \$381,000 in 2004. The main changes in operating assets and liabilities in fiscal 2005, which increased by \$58,000, were a decrease in inventories of \$306,000, offset by lower accounts payable of \$401,000. Accounts receivable increased by 1%, or \$84,000, based a 9% increase in revenues. Accrued compensation and expenses decreased by \$144,000 and accrued income taxes were \$2,000 below last year.

The Company has no long-term debt and has overdraft facilities in the United Kingdom (UK) amounting to \$1,946,000 and in France of \$121,000. These facilities were unused at September 30, 2005 and September 30, 2004. The UK overdraft facilities are secured by all of the Company's assets in the UK and are due for renewal in September 2006 but, in line with normal practice in Europe, can be withdrawn on demand by the bank. The French overdraft facilities are unsecured and are due for renewal in September 2006 but, in line with normal practice in Europe, can be withdrawn on demand by the bank.

At September 30, 2005 the Company's cash balances were \$1,130,000 and there was no short-term or long-term debt. The Company has, since January 1990, maintained a program of regular cash dividends. The dividends amounted to \$95,000 per quarter in fiscal 2005. In the opinion of management, the Company's requirements for working capital to meet future business growth can be met by a combination of existing cash resources, future earnings and existing borrowing facilities in Europe. The Company's capital expenditures are not expected, on average over a two to three year period, to exceed the depreciation charge which over the last three fiscal years averaged \$622,000. There were no significant capital expenditure commitments at September 30, 2005. Tech/Ops Sevcon's resources, in the opinion of management, are adequate for projected operations and capital spending programs, as well as continuation of cash dividends.

### C) Off balance sheet arrangements

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

### D) Contractual Obligations

Set out below are the Company's contractual obligations at September 30, 2005:

	(in thousands of dollars)				
	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Long-term debt obligations	\$ -	\$ -	\$ -	\$ -	\$ -
Capital lease obligations	-	-	-	-	-
Operating lease obligations	2,654	207	399	390	1,658
Purchase Obligations	2,584	2,584	-	-	-
Other long term liabilities	-	-	-	-	-
Total	\$5,238	\$2,791	\$ 399	\$ 390	\$1,658

### ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's operations are sensitive to a number of market factors any one of which could materially adversely affect its results of operations in any given year. Other risks dealing with contingencies are described in Notes (1)J and (5) to the Company's Consolidated Financial Statements included



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under Item 8 and other risks are described under the caption Risk Factors in Item 7 above.

### Foreign currency risk

The Company sells to customers throughout the industrialized world. In fiscal 2005 approximately 41% of the Company's sales were made in US Dollars, 24% were made in British Pounds and 35% were made in Euros. The majority of the Company's products are assembled in the United Kingdom and approximately 80% of the Company's cost of sales was incurred in British Pounds. This resulted in the Company's sales and margins being exposed to fluctuations due to the change in the exchange rates of the US Dollar, the British Pound and the Euro.

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

The Company undertakes hedging activities to manage the foreign exchange exposures related to forecast purchases and sales in foreign currency and the associated foreign currency denominated receivables and payables. The Company does not engage in speculative foreign exchange transactions. Details of this hedging activity and the underlying exposures are contained in Note (1) J. to the Company's consolidated financial statements included under Item 8.

Because the difference between the spot and hedged foreign exchange rates at September 30, 2005 was 2%, and amounted to \$21,000, the risk of default by counterparties is not material to the Company.

### Interest Rate Risk

The Company does not currently have any interest bearing debt. The Company does invest surplus funds in instruments with maturities of less than 12 months at both fixed and floating interest rates. The Company incurs short-term borrowings from time-to-time on its overdraft facilities in Europe at variable interest rates. Due to the short-term nature of the Company's investments at September 30, 2005 the risk arising from changes in interest rates was not material.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

### CONSOLIDATED BALANCE SHEETS

Tech/Ops Sevcon, Inc. and Subsidiaries

September 30, 2005 and 2004 (in thousands of dollars except per share data)

ASSETS	2005	2004
Current assets:		
Cash and cash equivalents	\$ 1,130	\$ 905
Receivables, net of allowances for doubtful accounts of \$144 in 2005 and \$192 in 2004	6,193	6,109
Inventories	3,737	4,043
Prepaid expenses and other current assets	915	931
Total current assets	11,975	11,988
Property, plant and equipment, at cost:		
Land and improvements	25	25
Buildings and improvements	2,139	2,186
Equipment	7,429	7,059

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	9,593	9,270
Less: accumulated depreciation and amortization	6,557	6,085
Net property, plant and equipment	3,036	3,185
Goodwill	1,435	1,435
Total assets	\$16,446	\$16,608
-----		
LIABILITIES AND STOCKHOLDERS' INVESTMENT		
-----		
Current liabilities:		
Accounts payable	\$ 2,599	\$ 3,001
Dividend payable	95	94
Accrued expenses	2,685	2,541
Accrued and deferred taxes on income	445	447
Total current liabilities	5,824	6,083
Deferred taxes on income	33	61
Commitments and contingencies (note 5)		
-----		
Stockholders' investment		
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 3,172,051 shares in 2005 and 3,125,051 shares in 2004	317	313
Premium paid in on common stock	4,310	4,047
Retained earnings	6,394	6,133
Unearned compensation on restricted stock	(180)	-
Cumulative other comprehensive loss	(252)	(29)
Total stockholders' investment	10,589	10,464
Total liabilities and stockholders' investment	\$16,446	\$16,608
-----		

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

CONSOLIDATED STATEMENTS OF INCOME  
Tech/Ops Sevcon, Inc. and Subsidiaries

For the Years ended September 30, 2005, 2004 and 2003  
(in thousands except per share data)

	2005	2004	2003
Net sales	\$31,675	\$29,150	\$23,113
Costs and expenses:			
Cost of sales	19,639	17,605	14,308
Selling, research and administrative	11,037	10,573	8,654
	30,676	28,178	22,962

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Operating income	999	972	151
Interest expense	(56)	(29)	(57)
Interest income	4	1	2
Foreign currency gain or (loss)	4	(26)	32
Income before income taxes	951	918	128
Income taxes	(310)	(307)	(45)
Net income	\$ 641	\$ 611	\$ 83
Basic income per share	\$ .21	\$ .20	\$ .03
Diluted income per share	\$ .20	\$ .19	\$ .03

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
Tech/Ops Sevcon, Inc. and Subsidiaries

For the Years ended September 30, 2005, 2004 and 2003  
(in thousands of dollars)

	2005	2004	2003
Net income	\$ 641	\$ 611	\$ 83
Foreign currency translation adjustment	(208)	574	481
Changes in fair market value of cash flow hedges	(15)	6	6
Comprehensive income	\$ 418	\$ 1,191	\$ 570

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' INVESTMENT  
Tech/Ops Sevcon, Inc. and Subsidiaries

For the Years ended September 30, 2005, 2004 and 2003  
(in thousands of dollars except per share data)

	Common stock	Premium paid in on common stock	Retained earnings	Unearned compensation on restricted stock	Cumulative other comprehensive income (loss)	Total stockholders' investment
Balance September 30, 2002	\$ 313	\$ 4,047	\$ 6,189	-	\$ (1,096)	\$ 9,453
Net income	-	-	83	-	-	83
Dividends (\$.12 per share)	-	-	(375)	-	-	(375)
Currency translation adjustment	-	-	-	-	481	481
Change in fair market value of cash flow hedge	-	-	-	-	6	6
Balance September 30, 2003	313	4,047	5,897	-	(609)	9,648
Net income	-	-	611	-	-	611

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Dividends (\$.12 per share)	-	-	(375)	-	-	(375)
Currency translation adjustment	-	-	-	-	574	574
Change in fair market value of cash flow hedge	-	-	-	-	6	6
-----						
Balance September 30, 2004	313	4,047	6,133	-	(29)	10,464
Net income	-	-	641	-	-	641
Dividends (\$.12 per share)	-	-	(380)	-	-	(380)
Currency translation adjustment	-	-	-	-	(208)	(208)
Change in fair market value of cash flow hedge	-	-	-	-	(15)	(15)
Issuance of restricted stock	4	263	-	(267)	-	-
Restricted stock expense	-	-	-	87	-	87
-----						
Balance September 30, 2005	\$317	\$4,310	\$6,394	\$ (180)	\$ (252)	\$10,589
-----						

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

CONSOLIDATED STATEMENTS OF CASH FLOWS  
Tech/Ops Sevcon, Inc. and Subsidiaries

For the Years ended September 30, 2005, 2004 and 2003

(in thousands of dollars)

	2005	2004	2003
-----			
Cash flow from operating activities:			
Net income	\$ 641	\$ 611	\$ 83
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	661	630	575
Stock-based compensation	87	-	-
Deferred tax benefit	(6)	(41)	(201)
Increase (decrease) in cash resulting from changes in operating assets and liabilities:			
Receivables	(84)	(1,971)	(150)
Inventories	306	(44)	138
Prepaid expenses and other current assets	(21)	(138)	(32)
Accounts payable	(401)	1,511	84
Accrued expenses	144	218	(42)
Accrued and deferred taxes on income	(2)	295	(8)
Net cash generated from operating activities	1,324	1,071	447
-----			
Cash flow used by investing activities:			
Acquisition of property, plant and equipment	(571)	(628)	(564)
Net cash used by investing activities	(571)	(628)	(564)
-----			

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Cash flow used by financing activities:			
Dividends paid	(379)	(375)	(375)
-----			
Net cash used by financing activities	(379)	(375)	(375)
-----			
Effect of exchange rate changes on cash	(149)	313	321
-----			
Net increase (decrease) in cash	225	381	(171)
Beginning balance - cash and cash equivalents	905	524	695
-----			
Ending balance - cash and cash equivalents	\$ 1,130	\$ 905	\$ 524
-----			
Supplemental disclosure of cash flow information:			
Cash paid for income taxes	\$ 354	\$ 44	\$ 237
Cash paid for interest	\$ 56	\$ 29	\$ 57
-----			
Supplemental disclosure of non-cash financing activity:			
Dividend declared	\$ 95	\$ 94	\$ 94
-----			

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

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Tech/Ops Sevcon, Inc. and Subsidiaries

#### (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### A. Basis of presentation

The accompanying consolidated financial statements include the accounts of Tech/Ops Sevcon, Inc. (Tech/Ops Sevcon), Sevcon, Inc., Sevcon Limited and subsidiaries, Sevcon SA and Sevcon Asia Limited. All material intercompany transactions have been eliminated. Certain prior year amounts have been reclassified to conform to the current year presentation.

##### B. Revenue recognition

The Company recognizes revenue upon shipment of its products. The Company's only post shipment obligation relates to warranty in the normal course of business for which ongoing reserves, which management believes to be adequate, are maintained. The movement in warranty reserves was as follows:

	(in thousands of dollars)	
	2005	2004
Warranty reserves at beginning of year	\$ 386	\$ 404
Decrease in beginning balance for warranty obligations settled during the year	(338)	(331)
Other changes to pre-existing warranties	5	6
Net increase in warranty reserves for products sold during the year	311	307
Warranty reserves at end of year	\$ 364	\$ 386

##### C. Research and development

The cost of research and development programs is charged against income as incurred and amounted to approximately \$3,499,000 in 2005, \$3,952,000 in

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2004 and \$2,976,000 in 2003. This expense is included in selling, research and administrative expense in the income statement. Research and development expense was 11.0% of sales in 2005 compared to 13.6% in 2004 and 12.9% in 2003. Research and development expense in fiscal 2005 decreased by \$453,000, or 11% compared to last fiscal year. This reduction was mainly due to lower engineering consultancy costs, as our advanced new product developments moved into their production phase. The decrease in engineering consultancy costs in fiscal 2005 was partly offset by the recruitment of additional internal engineers and by foreign currency fluctuations.

### D. Depreciation and maintenance

Plant and equipment are depreciated on a straight-line basis over their estimated useful lives, which are primarily fifty years for buildings, seven years for equipment and four years for computer equipment and software. Maintenance and repairs are charged to expense and renewals and betterments are capitalized.

### E. Stock based compensation plans

Statement of Financial Accounting Standards Board ("SFAS") # 123 "Accounting for Stock-Based Compensation" as amended by SFAS #148 "Accounting for Stock-Based Compensation - Transition and Disclosure" and to be replaced by SFAS # 123R "Share-Based Payment" defines a fair value based method of accounting for employee stock options or similar equity instruments and encourages all entities to adopt that method of accounting. However, it also allows an entity to continue to measure compensation costs using the method of accounting prescribed by Accounting Principles Board ("APB") #25 "Accounting for Stock Issued to Employees". Until SFAS # 123R becomes effective at the beginning of fiscal 2006 the Company will continue to account for its stock-based compensation plans under APB #25, under which no compensation cost has been recognized. Had compensation cost for these plans been determined consistent with SFAS #123R, the Company's net income and earnings per share would have equaled the following pro forma amounts:

(in thousands of dollars except per share data)			
	2005	2004	2003
Net income - As reported	\$ 641	\$ 611	\$ 83
Pro-forma effect of expensing stock options (net of tax)	\$ (52)	\$ (66)	\$ (66)
Net income - Pro forma	\$ 589	\$ 545	\$ 17
Basic net income per share - As reported	\$ .21	\$ .20	\$ .03
Basic net income per share - Pro forma	\$ .19	\$ .17	\$ .01
Diluted net income per share - As reported	\$ .20	\$ .19	\$ .03
Diluted net income per share - Pro forma	\$ .19	\$ .17	\$ .01

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2005	2004	2003
Risk-free interest rate	N/A	N/A	3.0%
Expected dividend yield	N/A	N/A	2.7%
Expected life (years)	N/A	N/A	7

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Expected volatility of N/A N/A 47%

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There were no option grants in either fiscal 2005 or 2004.

In November 2004 the Company granted 35,000 shares of restricted stock to five employees which will vest in five equal annual installments providing that the grantee remains an employee of the Company, or as determined by the Compensation Committee. In January 2005 the Company granted 12,000 shares of restricted stock to six non-employee directors which will vest on the day before the 2006 annual meeting, provided that the grantee remains a director of the Company, or as determined by the Compensation Committee. Details of these restricted stock grants are contained in Note 3, Stock Based Compensation Plans, on page 22.

During the restriction period, five years for employees and one year for non-employee directors, ownership of unvested shares cannot be transferred. Restricted stock has the same cash dividend and voting rights as other common stock and is considered to be currently issued and outstanding. For the purposes of calculating average issued shares for earnings per shares these shares are only considered to be outstanding when the forfeiture conditions lapse and the shares vest.

The stock-based compensation expense in the last three fiscal years was as follows:

	(in thousands of dollars)		
	2005	2004	2003
Stock option expense under SFAS # 123 *	\$ -	\$ -	\$ -
Restricted stock grants:			
Employees	\$ 30	\$ -	\$ -
Non-employee directors	\$ 57	\$ -	\$ -
<b>Total stock based compensation expense</b>	<b>\$ 87</b>	<b>\$ -</b>	<b>\$ -</b>

\* The pro-forma effect of expensing stock options (net of tax) accounted for under APB # 25 was \$52,000 in 2005, \$66,000 in 2004 and \$66,000 in 2003.

### F. Income taxes

Tech/Ops Sevcon files tax returns in the respective countries in which it operates. The financial statements reflect the current and deferred tax consequences of all events recognized in the financial statements or tax returns.

### G. Inventories

Inventories are valued at the lower of cost or market. Inventory costs include materials, direct labor and manufacturing overhead, and are relieved from inventory on a first-in, first-out basis. The Company's reported financial condition includes a provision for estimated slow-moving and obsolete inventory that is based on a comparison of inventory levels with forecast future demand. Such demand is estimated based on many factors, including management judgments, relating to each customer's business and to economic conditions. The Company reviews in detail all significant inventory items with holdings in excess of estimated normal requirements. It also considers the likely impact of changing technology. It makes an estimate of the provision for slow moving and obsolete stock on an item-by-item basis based on a combination of likely usage based on forecast customer demand,

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potential sale or scrap value and possible alternative use. This provision represents the difference between original cost and market value at the end of the financial period. In cases where there is no estimated future use for the inventory item and there is no estimated scrap or resale value, a 100% provision is recorded. Where the Company estimates that only part of the total holding of an inventory item will not be used, or there is an estimated scrap, resale or alternate use value, then a proportionate provision is recorded. Once an item has been written down, it is not subsequently revalued upwards. The provision for slow moving and obsolete inventories at September 30, 2005 was \$803,000, or 18% of the original cost of gross inventory. At September 30, 2004 the provision was \$951,000, or 19% of gross inventory. Inventories were comprised of:

	(in thousands of dollars)	
	2005	2004
Raw materials	\$ 1,596	\$ 2,076
Work-in-process	174	177
Finished goods	1,967	1,790
	\$ 3,737	\$ 4,043

### H. Accounts receivable

In the normal course of business, the Company provides credit to customers, performs credit evaluations of these customers, monitors payment performance, and maintains reserves for potential credit losses in the allowance for doubtful accounts which, when realized, have historically been within the range of the Company's reserves.

### I. Translation of foreign currencies

Tech/Ops Sevcon translates the assets and liabilities of its foreign subsidiaries at the current rate of exchange, and income statement accounts at the average exchange rates in effect during the period. Gains or losses from foreign currency translation are credited or charged to cumulative translation adjustment included in the statement of comprehensive income and as a component of cumulative other comprehensive income in stockholders' investment in the balance sheet. Foreign currency transaction gains and losses are included in costs and expenses.

### J. Derivative instruments and hedging

The Company accounts for derivative instruments and hedging under SFAS #133, "Accounting for Derivative Instruments and Hedging Activities", which requires that all derivatives, including foreign currency exchange contracts, be recognized on the balance sheet at fair value. Derivatives that are not hedges must be recorded at fair value through earnings. If a derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in fair value of assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings.

The Company sells to customers throughout the industrialized world. The majority of the Company's products are manufactured in the United Kingdom. Approximately 41% of the Company's sales are made in US Dollars, 24% are made in British Pounds and 35% are made in Euros. Over 80% of the Company's cost of sales is incurred in British Pounds. This results in the Company's



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sales and margins being exposed to fluctuations due to the change in the exchange rates of the US Dollar, the British Pound and the Euro.

Forward foreign exchange contracts are used primarily by the Company to hedge the operational ("cash-flow" hedges) and balance sheet ("fair value" hedges) exposures resulting from changes in foreign currency exchange rates described above. These foreign exchange contracts are entered into to hedge anticipated intercompany product purchases and third party sales and the associated accounts payable and receivable made in the normal course of business. Accordingly, these forward foreign exchange contracts are not speculative in nature. As part of its overall strategy to manage the level of exposure to the risk of foreign currency exchange rate fluctuations, the Company hedges a portion of its foreign currency exposures anticipated over the ensuing 9-month period. At September 30, 2005, the Company had effectively hedged approximately 8% of its estimated foreign currency exposures that principally relate to anticipated cash flows to be remitted to the UK over the next year, using foreign exchange contracts that have maturities of twelve months or less. The Company does not hold or transact in financial instruments for purposes other than risk management.

Under hedge accounting, the Company records its foreign currency exchange contracts at fair value in its consolidated balance sheet as other current assets and a portion of the related gains or losses on these hedge contracts related to anticipated transactions are deferred as a component of other comprehensive income. These deferred gains and losses will be recognized in income in the period in which the underlying anticipated transaction occurs.

Unrealized gains and losses resulting from the impact of currency exchange rate movements on forward foreign exchange contracts designated to offset certain functional currency denominated assets are recognized as other income or expense in the period in which the exchange rates change and offset the foreign currency losses and gains on the underlying exposures being hedged.

The Company discontinues hedge accounting prospectively when (1) it is determined that the derivative is no longer effective in offsetting changes in fair value or cash flows of a hedged item (including forecasted transactions); (2) the derivative is sold or terminated; (3) the derivative is de-designated as a hedge instrument, because it is unlikely that a forecasted transaction will occur or a balance sheet exposure ceases to exist; or (4) management determines that designation of the derivative as a hedge instrument is no longer appropriate.

The following table provides information about the Company's foreign currency derivative financial instruments outstanding as of September 30, 2005 and 2004. The information is provided in US Dollar amounts, as presented in the Company's consolidated financial statements. The table presents the notional amount (at contract exchange rates) and the weighted average contractual foreign currency exchange rates. All contracts mature within twelve months.

Foreign currency spot/forward contracts:

(in thousands, except average contract rates)					
		2005	2004		
		Notional Amount	Average Contract Rate	Notional Amount	Average Contract Rate
Sell Euros (EUR) for					
British Pounds (GBP)	\$	-	-	\$1,984	EUR1.47 = GBP1

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Sell US Dollars for				
British Pounds	\$ 1,050	\$1.80 = GBP1	\$2,450	\$ 1.75 = GBP1
-----				
Total	\$ 1,050		\$4,434	
-----				
Estimated fair value *	\$ (21)		\$ 62	
-----				
Amount recorded as other				
comprehensive income	\$ -		\$ 6	
-----				

\*The estimated fair value is based on the estimated amount at which the contracts could be settled based on forward exchange rates.

### K. Cash equivalents and short-term investments

The Company considers all highly liquid investments with a maturity of 90 days or less to be cash equivalents. Highly liquid investments with maturities greater than 90 days and less than one year are classified as short-term investments.

Such investments are generally money market funds, bank certificates of deposit, US Treasury bills and short-term bank deposits in Europe.

### L. Earnings per share

Basic and diluted net income per common share for the three years ended September 30, 2005 are calculated as follows:

	(in thousands except per share data)		
	2005	2004	2003
-----			
Net income	\$ 641	\$ 611	\$ 83
Weighted average shares outstanding	3,125	3,125	3,125
Basic income per share	\$ .21	\$ .20	\$ .03
-----			
Common stock equivalents	27	22	4
Average common and common equivalent shares outstanding	3,152	3,147	3,129
Diluted income per share	\$ .20	\$ .19	\$ .03
-----			

For the years ended 2005, 2004 and 2003 respectively, approximately 105,000, 106,000 and 116,000 shares attributable to the exercise of outstanding options were excluded from the calculation of diluted earnings per share because the effect was antidilutive.

### M. Use of estimates in the preparation of financial statements

The presentation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of income and expenses during the reporting periods. The most significant estimates and assumptions made by management include bad debt, inventory and warranty reserves, goodwill impairment assessment, pension plan assumptions and income tax assumptions. Operating results in the future could vary from the amounts derived from management's estimates and assumptions.

### N. Fair value of financial instruments

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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 September 30, 2005, approximates fair value due to the short-term nature of these instruments.

### O. Goodwill

The amount by which the cost of purchased businesses included in the accompanying financial statements exceeded the fair value of net assets at the date of acquisition has been recorded as "goodwill". The Company assesses the carrying value of this asset whenever events or changes in circumstances indicate that this value has diminished. The Company considers the future profitability of the business in assessing the value of this asset.

In accordance with SFAS #142 "Goodwill and Other Intangible Assets" the Company performs an annual assessment of goodwill impairment and has determined that goodwill has not been impaired.

### P. New Accounting Pronouncements

In October 2004, the President signed into law the American Jobs Creation Act (the Act). The Act allows for a federal income tax deduction for a percentage of income earned from certain domestic production activities. The Company's domestic, or U.S., production activities may qualify for the deduction. Based on the effective date of the Act, the Company would be eligible for this deduction in the first quarter of fiscal 2006. Additionally, on December 21, 2004, the FASB issued FASB Staff Position 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes (SFAS No. 109), to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004" (FSP 109-1). FSP 109-1, which was effective upon issuance, states that the deduction under this provision of the Act should be accounted for as a special deduction in accordance with SFAS 109. The Company has not yet quantified the benefit that may be realized from this provision of the Act.

The Act also allows for an 85% dividends received deduction on the repatriation of certain earnings of foreign subsidiaries. On December 21, 2004, the FASB issued FASB Staff Position 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004" (FSP 109-2). FSP 109-2, which was effective upon issuance, allows companies time beyond the financial reporting period of enactment to evaluate the effect of the Act on its plan for reinvestment or repatriation of foreign earnings for purposes of applying SFAS No. 109. Additionally FSP 109-2 provides guidance regarding the required disclosures surrounding a company's reinvestment or repatriation of foreign earnings. The Company continues to evaluate this provision of the Act to determine the amount of foreign earnings to repatriate. Currently the Company does not expect the potential repatriation to have a material impact on its effective tax rate.

In November 2004, the Financial Accounting Standards Board issued SFAS #151, "Inventory Costs - an amendment of ARB No. 43" ("SFAS #151"), which is the result of its efforts to converge U.S. accounting standards for inventories with International Accounting Standards. SFAS #151 requires idle facility expenses, freight, handling costs, and wasted material (spoilage) costs to be recognized as current-period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS #151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005.

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The Company is evaluating the impact of this standard on its consolidated financial statements.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) #123R, "Share-Based Payment". This Statement, when effective, will replace SFAS #123, "Accounting for Stock based Compensation" and supersede APB #25, "Accounting for Stock Issued to Employees". This Statement establishes fair value on the grant date as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value-based measurement method in accounting for share-based payment transactions with employees except for equity instruments held by employee share ownership plans. This Statement is effective for public entities that do not file as small business issuers as of the beginning of the first annual reporting period that begins after June 15, 2005.

In addition, in March 2005, the SEC issued Staff Accounting Bulletin No. 107, "Share-Based Payment" (SAB 107). SAB 107 provides supplemental implementation guidance on Statement 123R, including guidance on valuation methods, classification of compensation expense, inventory capitalization of share-based compensation cost, income tax effects, disclosures in Management's Discussion and Analysis and several other issues.

The Company will adopt the provisions of SFAS #123R effective at the beginning of fiscal 2006. The Company will adopt the modified prospective application transition method. Under this method the Company expects to incur expense relating to previously issued stock options of approximately \$30,000 in fiscal 2006. The accounting for restricted stock issued in fiscal 2005 will be substantially unchanged by the application of SFAS #123R.

### (2) CAPITAL STOCK

Tech/Ops Sevcon, Inc. has two classes of capital stock, preferred and common. There are authorized 1,000,000 shares of preferred stock, \$.10 par value and 8,000,000 shares of common stock, \$.10 par value.

The company issued 47,000 shares of restricted stock to employees and directors in fiscal 2005.

### (3) STOCK-BASED COMPENSATION PLANS

Under the Company's 1996 Equity Incentive Plan there were 100,000 shares reserved and available for grant at September 30, 2005. No options were granted or exercised in fiscal 2005 or 2004. In fiscal 2003 options for 77,000 shares were granted to employees and options for 5,000 shares were granted to a new director. Options for a total of 25,000 shares granted to 5 directors in 1998 are also outstanding.

Recipients of grants or options must execute a standard form of non-competition agreement. This plan provides for the grant of Restricted Stock, Restricted Stock Units, Options, and Stock Appreciation Rights (SARs). Stock Appreciation Rights 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.

Option transactions under the plans for the three years ended September 30, 2005 were as follows:

	Weighted average
Shares under option	exercise price

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Outstanding at September 30, 2002	114,500	\$ 12.79
Granted in 2003	82,000	\$ 4.47
Cancelled in 2003	(3,500)	\$ 10.91
-----		
Outstanding at September 30, 2003	193,000	\$ 9.29
Cancelled in 2004	(5,000)	\$ 4.37
-----		
Outstanding at September 30, 2004	188,000	\$ 9.42
Cancelled in 2005	(6,000)	\$ 14.48
-----		
Outstanding at September 30, 2005	182,000	\$ 9.26
-----		
Exercisable at September 30, 2005	100,500	\$ 10.73
-----		

Details of options outstanding at September 30, 2005 were as follows:

Price range	Shares under option	Weighted average remaining contractual life
\$ 4.37 - \$ 6.56	77,000	8 years
\$ 6.57 - \$ 9.85	10,000	6 years
\$ 9.86 - \$14.79	75,000	3 years
\$14.80 - \$22.20	20,000	2 years
-----		
	182,000	4 years
-----		

In November 2004 the Company granted 35,000 shares of restricted stock to five employees which will vest in five equal annual installments providing that the grantee remains an employee of the Company, or as determined by the Compensation Committee. The estimated fair value of the stock on the date of grant was \$182,000 based on the fair market value of the stock on date of issue and estimated forfeitures of 4% per year. The estimated forfeitures are based on the historical rate of turnover of the relevant group of employees. This amount was credited to common stock and paid in surplus and the \$182,000 was recorded as "Unearned compensation on restricted stock", a deduction from stockholders equity. The unearned compensation is being charged to income on a straight line basis over the five year period during which the forfeiture conditions lapse. The charge to income for employee restricted stock grants in fiscal 2005 was \$30,000 and the subsequent charge will be approximately \$36,000 per year.

In January 2005 the Company granted 12,000 shares of restricted stock to six non-employee directors which will vest on the day before the 2006 annual meeting, provided that the grantee remains a director of the Company, or as determined by the Compensation Committee. The estimated fair value of the stock on the date of grant was \$85,000 based on the fair market value of the stock on date of issue. Due to the short-term vesting period no forfeitures have been estimated. This amount was credited to common stock and paid in surplus and the \$85,000 was recorded as "Unearned compensation on restricted stock", a deduction from stockholders equity. The unearned compensation is being charged to income on a straight line basis over the one year period during which the forfeiture conditions lapse. The charge to income for non-employee directors' restricted stock grants in fiscal 2005 was \$57,000 and there will be a further charge to income in fiscal 2006 of \$28,000.

During the restriction period, five years for employees and one year for non-employee directors, ownership of unvested shares cannot be transferred. Restricted stock has the same cash dividend and voting rights as other common stock and is considered to be currently issued and outstanding. For

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the purposes of calculating average issued shares for earnings per share these shares are only considered to be outstanding when the forfeiture conditions lapse and the shares vest.

Restricted stock transactions under the plans for the three years ended September 30, 2005 were as follows:

	(in thousands of shares)		
	2005	2004	2003
Beginning Balance	-	-	-
Granted to employees - 5 year vesting	35	-	-
Granted to non-employee directors - 1 year vesting	12	-	-
Ending Balance	47	-	-
Weighted-average fair value for shares granted during the year	\$ 5.68	\$ -	\$ -

#### (4) INCOME TAXES

The domestic and foreign components of income before income taxes are as follows:

	(in thousands of dollars)		
	2005	2004	2003
Domestic	\$ 1	\$ 5	\$ (497)
Foreign	950	913	625
	\$ 951	\$ 918	\$ 128

The components of the provision / (benefit) for income taxes for the years ended September 30, 2005, 2004 and 2003 are as follows:

	(in thousands of dollars)		
	2005		
	Current	Deferred	Total
Federal	\$ 24	\$ (32)	\$ (8)
State	7	8	15
Foreign	338	(35)	303
	\$ 369	\$ (59)	\$ 310
	2004		
	Current	Deferred	Total
Federal	\$ 26	\$ (25)	\$ 1
State	21	(5)	16
Foreign	299	(9)	290
	\$ 346	\$ (39)	\$ 307
	2003		
	Current	Deferred	Total

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Federal	\$ -	\$ (151)	\$ (151)
State	5	(31)	(26)
Foreign	241	(19)	222
	\$ 246	\$ (201)	\$ 45

The provision for income taxes in each period differs from that which would be computed by applying the statutory US Federal income tax rate to the income before income taxes. The following is a summary of the major items affecting the provision:

(in thousands of dollars)

	2005	2004	2003
Statutory Federal income tax rate	34%	34%	34%
Computed tax provision at statutory rate	\$ 323	\$ 312	\$ 44
Increases (decreases) resulting from:			
Foreign tax rate differentials	(20)	(28)	(23)
State taxes net of federal tax benefit	(7)	1	(17)
Change in deferred tax valuation allowance	7	(15)	-
Foreign tax credits and other	7	37	41
Income tax provision in the Statement of Income	\$ 310	\$ 307	\$ 45

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will either expire before the Company is able to realize the benefit, or that future deductibility is uncertain. The significant items comprising the domestic and foreign deferred tax accounts at September 30, 2005 and 2004 are as follows:

(in thousands of dollars)

	2005		
	Domestic current	Foreign current	Foreign long-term
<b>Assets:</b>			
Pension accruals (prepaid)	\$ 274	\$ 22	\$ -
Inventory basis differences	49	30	-
Warranty reserves	42	-	-
Foreign tax credit carry forwards	150	-	-
Other (net)	126	1	-
	641	53	-
<b>Liabilities:</b>			
Property basis differences	-	-	(33)
Net asset (liability)	641	53	(33)
Valuation allowance	(131)	-	-
Net deferred tax asset (liability)	\$ 510	\$ 53	\$ (33)

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2004

	Domestic current	Foreign current	Foreign long-term
<b>Assets:</b>			
Pension accruals (prepaid)	\$ 252	\$ (8)	\$ -
Inventory basis differences	105	31	-
Warranty reserves	47	-	-
Foreign tax credit carry forwards	181	-	-
Other (net)	103	29	-
	688	52	-
<b>Liabilities:</b>			
Property basis differences	-	-	(61)
Net asset (liability)	688	52	(61)
Valuation allowance	(205)	-	-
Net deferred tax asset (liability)	\$ 483	\$ 52	\$ (61)

(5) ACCRUED EXPENSES

The analysis of accrued expenses at September 30, 2005 and 2004, showing separately any items in excess of 5% of total current liabilities, was as follows:

(in thousands of dollars)

	2005	2004
Accrued compensation and related costs	\$ 1,101	\$ 979
Warranty reserves	364	386
Other accrued expenses	1,220	1,176
	\$ 2,685	\$ 2,541

(6) COMMITMENTS AND CONTINGENCIES

In fiscal 2002 the Company received a demand for repayment of an alleged preference payment of \$180,000 received from a customer in the 90 days prior to their filing for protection under Chapter 11 during fiscal 2000. At the time this customer filed for Chapter 11 protection it owed the Company \$50,000 and this amount was fully reserved in the fiscal 2000 financial statements. The Company settled this claim in October 2005 and the cost of settlement of \$90,000 was fully reserved at September 30, 2005.

Tech/Ops Sevcon is involved in various other 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 September 30, 2005 was \$204,000.

Minimum rental commitments under all non-cancelable leases are as follows



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for the years ended September 30: 2006 - \$207,000; 2007 - \$204,000; 2008 - \$195,000; 2009 - \$195,000; 2010 - \$195,000 and \$1,658,000 thereafter. Net rentals of certain land, buildings and equipment charged to expense were \$214,000 in 2005, \$207,000 in 2004, and \$195,000 in 2003.

The UK subsidiaries of the Company have given to a bank a security interest in all of their assets as security for overdraft facilities of \$1,991,000. There were no amounts outstanding on the overdraft facilities at September 30, 2005 or 2004.

### (7) EMPLOYEE BENEFIT PLANS

Tech/Ops Sevcon has defined benefit plans covering the majority of its US and UK employees. There is also a small defined contribution plan. The following table sets forth the estimated funded status of these defined benefit plans and the amounts recognized by Tech/Ops Sevcon. The Company uses a September 30 measurement date for its pension plans.

	(in thousands of dollars)	
	2005	2004
-----		
Change in benefit obligation:		
Benefit obligation at beginning of year	\$14,418	\$12,486
Service cost	419	446
Interest cost	867	844
Plan participants contributions	234	199
Actuarial (gain) loss	514	(487)
Benefits paid	(252)	(38)
Foreign currency exchange rate changes	(290)	968
-----		
Benefit obligation at end of year	15,910	14,418
-----		
Change in plan assets:		
Fair value of plan assets at beginning of year	12,899	10,797
Return on plan assets	1,148	555
Employer contributions	444	518
Plan participants contributions	234	199
Benefits paid	(252)	(38)
Foreign currency exchange rate changes	(263)	868
-----		
Fair value of plan assets at end of year	14,210	12,899

	(in thousands of dollars)	
	2005	2004
-----		
Funded status	(1,700)	(1,519)
Unrecognized transition obligation (asset)	(3)	(5)
Unrecognized prior service cost	593	661
Unrecognized net actuarial (gain) loss	629	462
-----		
Accrued benefit cost	\$ (481)	\$ (401)

The Tech/Ops Sevcon net pension cost included the following components as defined by SFAS #132.

(in thousands of dollars)

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	2005	2004	2003
Components of net periodic benefit cost:			
Service cost	\$ 434	\$ 443	\$ 432
Interest cost	901	840	773
Expected return on plan assets	(845)	(844)	(775)
Amortization of transition obligation	(2)	(2)	(2)
Amortization of prior service cost	55	54	49
Recognized net actuarial gain (loss)	-	-	-
Net periodic benefit cost	\$ 543	\$ 491	\$ 477
Net cost of defined contribution plans	\$ 29	\$ 28	\$ 27

The weighted average assumptions used to determine plan obligations and net periodic benefit cost for the years ended September 30, 2005 and 2004 were as set out below:

	2005	2004
Plan obligations:		
Discount rate	5.80%	6.02%
Rate of compensation increase	3.93%	4.23%
Net periodic benefit cost:		
Discount rate	6.02%	6.25%
Expected long term return on plan assets	6.05%	6.43%
Rate of compensation increase	4.23%	4.30%

The reductions in these assumptions reflect actuarial advice and changing market conditions and experience.

The weighted average asset allocations by asset category are set out below for both the UK and US plans:

	(percentage of total assets)					
	2005			2004		
	US Plan	UK Plan	Total	US Plan	UK Plan	Total
Equity securities	40%	30%	31%	44%	32%	33%
Debt securities	56%	49%	50%	54%	45%	46%
Real estate	-	18%	16%	-	20%	18%
Other	4%	3%	3%	2%	3%	3%
Total	100%	100%	100%	100%	100%	100%

For the US plan the target asset allocations are 40% - 45% equity securities and 55% - 60% debt securities. The UK plan is invested in an insurance company with-profits unit fund which holds various investments as decided by the insurance company's fund manager, who is responsible for the asset allocation within the fund. The asset allocations of the insurance company with-profits units are included in the table above.

The overall expected long-term rate of return on plan assets has been based on the expected returns on equities, bonds and real estate based broadly on the current asset allocation, with a small reduction in the expected rate to

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reflect the conservative nature of the distributions from the insurance company with profits unit fund.

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

(in thousands of dollars)

2006	\$ 49
2007	98
2008	128
2009	164
2010	238
2011 - 2015	2,425

In fiscal 2006 it is estimated that the Company will make contributions to the plans of \$564,000, and that there will be employee contributions to the UK plan of \$246,000.

### (8) SEGMENT INFORMATION

The Company has two reportable segments: electronic controls and capacitors. The electronic controls segment produces control systems for battery powered vehicles. The capacitor segment produces electronic components for sale to electronic equipment manufacturers. Each segment has its own management team, manufacturing facilities and sales force.

The accounting policies of the segments are the same as those described in Note 1. Intersegment sales 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)

2005				
	Controls	Capacitors	Corporate	Total
Sales to external customers	\$30,009	\$ 1,666	\$ -	\$31,675
Inter-segment revenues	-	199	-	199
Operating income	1,343	32	(376)	999
Depreciation and amortization	611	50	-	661
Identifiable assets	14,948	951	547	16,446
Capital expenditures	536	35	-	571
2004				
	Controls	Capacitors	Corporate	Total
Sales to external customers	\$27,101	\$ 2,049	\$ -	\$29,150
Inter-segment revenues	-	218	-	218
Operating income	974	295	(297)	972
Depreciation and amortization	580	50	-	630
Identifiable assets	14,938	1,026	644	16,608
Capital expenditures	612	16	-	628
2003				

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	Controls	Capacitors	Corporate	Total
-----				
Sales to external customers	\$20,730			