TECH OPS SEVCON INC
Form 10-K
December 27, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended September 30, 2006 or

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

For the transition period from ________________________ to ______________________

Commission File Number 1-9789

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

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

155 Northboro Road, Southborough, Massachusetts 01772
(Address of Principal Executive Offices) (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 if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes **o** No **x**

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

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 **x** No **o**

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. **o**

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer **o** Accelerated Filer **o** Non accelerated filer **x**

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

As of April 1, 2006, 3,209,051 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 $15,450,000. As of December 14, 2006, 3,211,051 common shares were outstanding.

Documents incorporated by reference: Portions of the Proxy Statement for Annual Meeting of Stockholders to be held January 23, 2007 are incorporated by reference into Part III of this report.

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ITEM

PART IV

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

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

PART I

ITEM 1 BUSINESS

· General Description

Tech/Ops Sevcon, Inc. ("Tech/Ops Sevcon" or the "Company") is a Delaware corporation organized on December 22, 1987 to carry on the electronic controls business previously performed by Tech/Ops, Inc. (Tech/Ops). Through wholly-owned subsidiaries located in the United States, England, France, South Korea and Japan, the Company designs, 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 17% of sales in fiscal 2006 compared to 16% in fiscal 2005 and 11% in fiscal 2004.

In fiscal 2006 sales were $34,630,000, an increase of $2,955,000, or 9%, compared to the previous year. Foreign currency fluctuations accounted for a decrease of $500,000, or 2%, in reported sales. Excluding the foreign currency impact, volumes grew by 11% compared to fiscal 2005. Most of the markets for the Company's products are cyclical and, although several of the markets served by the Company grew in fiscal 2006, performance in the fork lift truck market declined. Operating income in fiscal 2006 was $1,844,000, compared to $999,000 in the previous year, an increase of 85%. Net income was $1,114,000, or $.35 per diluted share, compared to $641,000, or $.20 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 2006 performance.

· Marketing and sales

Sales are made primarily through a small full-time marketing staff. Sales in the United States were $14,643,000, $12,893,000 and $10,577,000, in fiscal years 2006, 2005 and 2004, respectively, which accounted for approximately 42%, 41% and 36%, respectively, of total sales. Approximately 64% of sales are made to 10 manufacturers of electric vehicles in the United States, Europe and the Far East. Approximately 89% of the Company's sales are direct to end customers, with 11% made to the Company's international dealer network. See Note 8 to the Consolidated Financial Statements (Segment Information) in this Annual Report for an analysis of sales by segment, geographic location and major customers.

· 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, 2006 was $4,923,000, compared to $4,957,000 at September 2005 and $3,601,000 at September 2004.

· 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 $3,582,000 in 2006, compared to $3,499,000 in 2005 and $3,952,000 in 2004. The increase in research and development spending of $83,000, or 2%, in fiscal 2006 was principally due to costs on a new product development for a specific customer partially offset by the effect of currency fluctuations.

· Environmental regulations

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

· Employees and labor relations

As of September 30, 2006, the Company employed 159 full-time employees, of whom 16 were in the United States, 130 were in the United Kingdom, 10 were in France, and 3 were in the Far East. Tech/Ops Sevcon believes its relations with its employees are good.

ITEM 1A RISK FACTORS

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

Capital 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 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 two plants 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.

Product liability claims may have a material adverse effect

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

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

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 (UK) 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 ground leases expiring in 2068 and 2121 respectively. During fiscal 2006 the UK subsidiary sub-let approximately 11,000 square feet of unused space in one of its buildings for a five-year term expiring in 2011. 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 Inchon City, near Seoul, under a lease due to expire in 2007. The Japanese subsidiary 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	44	President & Chief Executive Officer
Paul A. McPartlin	61	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, 2006, there were approximately 210 shareholders of record.

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Year
2006 Quarters					

Cash dividends per share	**$**	**.03**	**$**	**.03**	**$**	**.03**	**$**	**.03**	**$**	**.12**
Common stock price per share - High	**$**	**6.10**	**$**	**6.55**	**$**	**7.36**	**$**	**7.09**	**$**	**7.36**
- Low		**4.95**		**5.36**		**5.95**		**6.20**		**4.95**
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

Item 6 Selected Financial Data

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

As of September 30 (in thousands except per share data)

	2006	2005	2004	2003	2002
Net sales	**$ 34,630**	$ 31,675	$ 29,150	$ 23,113	$ 21,872
Operating income	**1,844**	999	972	151	45
Net income	**1,114**	641	611	83	57
Basic income per share	**$ .35**	$ .21	$ .20	$ .03	$ .02
Cash dividends per share	**$ .12**	$ .12	$ .12	$ .12	$ .30
Average shares outstanding	**3,139**	3,125	3,125	3,125	3,117
Stockholders' equity	**10,037**	10,589	10,464	9,648	9,453
Total assets	**$ 18,652**	$ 16,446	$ 16,608	$ 13,784	$ 13,521

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

FORWARD LOOKING STATEMENTS

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

NEW ACCOUNTING PRONOUNCEMENTS

The Company adopted the following new accounting pronouncements in fiscal 2006. See Note (1)P. to Consolidated Financial Statements for a more detailed description of these new accounting pronouncements.

The Company adopted the provisions of SFAS #123R "Share-Based Payment" effective at the beginning of fiscal 2006 using the modified prospective application transition method. Under this method the Company incurred expense relating to previously issued stock options of approximately $46,000 in fiscal 2006. There was no similar expense recorded in fiscal 2005 because, during that period, the Company accounted for options under APB #25. The accounting for restricted stock issued in fiscal 2005 was substantially unchanged by the application of SFAS #123R.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)." SFAS No. 158 requires an employer to recognize a plan's overfunded or underfunded status in its balance sheets and recognize the changes in a plan's funded status in comprehensive income in the year which the changes occur. The Company adopted SFAS #158 effective on September 30, 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 64% of the Company's sales. At September 30, 2006, the allowance for bad debts amounted to $141,000, 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 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, 2006 was $923,000, or 16% of the original cost of gross inventory. At September 30, 2005, the provision was $803,000, or 18% of gross inventory. If actual future demand or market conditions are less favorable than those projected by management, or if product designs change more quickly than forecast, additional inventory write-downs may be required, which may have a material adverse impact on reported results.

Warranty Costs

The Company provides for the estimated cost of product warranties at the time revenue is recognized. While the Company engages in product quality programs and processes, the Company's warranty obligation is affected by product failure rates and repair or replacement costs incurred in correcting a product failure. Accordingly, the provision for warranty costs is based upon anticipated in-warranty failure rates and estimated costs of repair or replacement. Anticipating product failure rates involves making difficult judgments about the likelihood of defects in materials, design and manufacturing errors, and other factors that are based in part on historical failure rates and trends, but also on management’s expertise in engineering and manufacturing. Estimated repair and replacement costs are affected by varying component and labor costs. Should actual product failure rates and repair or replacement costs differ from estimates, revisions to the estimated warranty liability may be required and the Company’s results may be materially adversely affected. In the event that the Company discovers a product defect that impacts the safety of its products, then a product recall may be necessary, which could involve the Company in substantial unanticipated expense significantly in excess of the reserve. There were no significant safety related product recalls during the past three 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 valuation methods require estimates of future revenues, profits, capital expenditures and working capital requirements which are based on evaluation of historical trends, current budgets, operating plans and industry data. Based on all of these valuation methods, management concluded that the goodwill had not been impaired. Management updated the analysis in 2005 and 2006 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 or libiliities relating to the pension plans, which could have a material effect on the Company’s financial position and results of operations. The company adopted SFAS #158 in September 2006 and recorded a liability for pension benefits of $2,886,000 on its balance sheet and a charge to comprehensive income of $1,923,000, net of tax. The Company’s pension plans are significant relative to the size of the Company. At September 30, 2006, pension plan assets were $17,590,000, plan liabilities were $20,476,000, and the total assets of the Company were $18,652,000. Under SFAS #158 changes in the funded status of the pension plans (plan assets less plan liabilities) are recorded in the Company’s balance sheet and could have a material effect on the Company’s financial position. At September 30, 2006, a decrease in the assumed discount rate of 0.1% would have resulted in an increase in the liability for pension benefits of approximately $440,000.

· **A) Results of Operations**

2006 compared to 2005

The following table compares results, for both the controls and capacitor segments, for fiscal 2006 with the prior year, showing separately the percentage variances due to currency and volume / other.

			% change due to:		
	2006	2005	Total	Currency	Volume / other
Sales					
Controls - to external customers	**$ 32,808**	$ 30,009	9%	-2%	11%
Capacitors- to external customers	**1,822**	1,666	9%	-3%	12%
Capacitors - inter-segment	**64**	199	-68%	-2%	-66%
Capacitors - total	**1,886**	1,865	1%	-3%	4%
Total sales to external customers	**34,630**	31,675	9%	-2%	11%
Gross Profit					
Controls	**12,268**	11,259	9%	0%	9%
Capacitors	**838**	777	8%	-2%	10%
Total	**13,106**	12,036	9%	0%	9%
Selling research and administrative expenses					
Controls	**10,094**	9,916	2%	-2%	4%
Capacitors	**770**	745	3%	-2%	5%
Unallocated corporate expense	**398**	376	6%	0%	6%
Total	**11,262**	11,037	2%	-2%	4%
Operating income					
Controls	**2,174**	1,343	62%	11%	51%
Capacitors	**68**	32	113%	-3%	116%
Unallocated corporate expense	**(398)**	(376)	6%	0%	6%
Total	**1,844**	999	85%	15%	70%
Other income and expense	**(110)**	(48)	129%	117%	12%
Income before income taxes	**1,734**	951	82%	10%	72%
Income taxes	**(620)**	(310)	100%	12%	88%
Net Income	**$ 1,114**	$ 641	74%	9%	65%

In fiscal 2006 sales revenues increased by $2,525,000, or 9%, to $34,630,000. In fiscal 2006 approximately 58% of the Company's sales were made outside the United States. As the majority of 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. In Fiscal 2006 the average dollar exchange rate strengthened compared to the British Pound by 2% and by 3% compared to the Euro. As a result, foreign currency sales translated into fewer dollars. Foreign currency fluctuations accounted for a 2% decrease in reported sales, even though volumes were 11% higher than the previous year.

In the controls business segment revenues were 9% higher than in fiscal 2005, reflecting a 2% decrease due to foreign currency fluctuations and an 11% increase in volumes shipped. In the United States controller business, sales were $14,643,000 compared to $12,893,000 in 2005, an increase of 14%. Non-U.S. sales volumes in the controller businesses improved by 9% compared to last year. In the aerial lift market volumes were 20% ahead of the prior year and volumes also increased in the other electric vehicle, mining and airport ground support markets. Volumes in the fork lift truck market declined by 8% compared to fiscal 2005.

In the capacitor business segment, revenues increased by $156,000, or 9%. Capacitor volumes increased by 12% compared to last year, but were partially offset by adverse foreign currency fluctuations. This volume increase was mainly due to stronger conditions in the railway signaling market for capacitors.

Cost of sales was $21,524,000 compared to $19,639,000 in fiscal 2005, an increase of $1,885,000, or 10%. Approximately 75% of this cost of sales was denominated in British Pounds. As a result foreign currency fluctuations decreased cost of sales by $450,000, or 2%. The remaining 12% increase in cost of sales was mainly due to higher volumes. Sales mix was marginally adverse, with volume gains concentrated in the lower than average margin aerial lift market.

Gross profit was $13,106,000, or 37.8% of sales, compared to $12,036,000, or 38.0% of sales, in fiscal 2005. Foreign currency fluctuations adversely impacted the gross profit percentage by $50,000, or 0.1%, with adverse sales mix the main cause of the remaining 0.1% decrease in the gross profit percentage. In the controls segment, gross profit of $12,268,000 was 9% ahead of last year; this compared to an increase in volumes of 11%. In the capacitor segment gross profit was $838,000, an increase of $61,000, or 8% compared to fiscal 2005. Capacitor business gross profit was 44.4% of sales in the current year compared to 41.7% of sales in fiscal 2005. The increase in capacitor business gross profit was mainly due to increased volumes.

Selling, research and administrative expenses (operating expenses) were $11,262,000, an increase of $225,000, or 2%, compared to fiscal 2005. Foreign currency fluctuations reduced reported operating expenses by $200,000, or 2%. Excluding the currency impact, operating expenses increased by $455,000, or 4%. In fiscal 2006, expenditure on new product engineering increased by $156,000, before the impact of currency fluctuations. Spending on sales and marketing resources in fiscal 2006, mainly to support the introduction of new products, increased by $264,000, before the impact of currency fluctuations. In fiscal 2006 the Company set up a subsidiary in Tokyo, Japan to improve service to customers in the Japanese market. Included in administrative expense was a charge of $175,000 in 2006 compared to $87,000 in fiscal 2005, relating to equity compensation expense. This included restricted stock granted to employees and directors and expensing options under SFAS #123R in 2006, which were previously accounted for under APB #25, under which no expense was recorded. 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)	
Reported expense in fiscal 2006	$	11,262
Reported expense in fiscal 2005		11,037
Increase in expense		225
Increase (decrease) due to:		
Effect of exchange rate changes		(200)
Additional engineering expense, net of currency effect		156
Additional sales and marketing expense, net of currency effect		264
Increased cost of equity compensation in 2006		88
Net other operating expense decreases		(108)
Total increase in selling research and administrative expenses in fiscal 2006		225

Operating income was $1,844,000 compared to $999,000 in fiscal 2005, an increase of $845,000, or 85%. Foreign currency fluctuations increased operating income by $150,000 in fiscal 2006. Excluding the currency effect, operating income increased by 70% compared to fiscal 2005, mainly due to increased volumes. In the controller business, and excluding the currency impact, operating income was 51% ahead of the prior year. Capacitor business operating income increased by 113% to $68,000 compared to $32,000 in fiscal 2005, mainly due to higher volumes.

Other expense was $110,000 in fiscal 2006 compared to $48,000 in the previous year. Interest expense increased by $8,000 to $64,000 and interest income in 2006 was $2,000 higher at $6,000. There was a foreign currency loss of $52,000 in 2006 compared to a foreign currency gain of $4,000 in 2005.

Income before income taxes was $1,734,000 compared to $951,000 in 2005, an increase of $783,000, or 82%. Foreign currency fluctuations increased pre tax income by $94,000 in fiscal 2006. Pre-tax income, before the effect of currency fluctuations, was 72% ahead of the prior year. Income taxes were 35.8% of pre-tax income compared to 32.6% in fiscal 2005. The higher tax rate was mainly due to a change in the deferred tax valuation allowance relating to foreign tax credits. Net income was $1,114,000, an increase of $473,000, or 74%, compared to $641,000 last year. Basic income per share was $.35 per share in 2006 compared to $.21 in fiscal 2005, an increase of 67%. Diluted income per share was $.35 per share in fiscal 2006, an increase of $.15 per share compared to last year.

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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.

				% change due to:	
	2005	2004	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%
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. Approximately 59% of the Company’s sales were made outside of the United States. 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 the previous 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 fiscal 2004, 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 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 the prior 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)
Reported expense in fiscal 2005	$	11,037
Reported expense in fiscal 2004		10,573
Increase in expense		464
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
Total increase in selling research and administrative expenses in fiscal 2005		464

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 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.

· B) Liquidity and Capital Resources

The Company's cash flow from operating activities for fiscal 2006 was $950,000 compared to $1,324,000 in the prior fiscal year. Acquisitions of property, plant and equipment amounted to $706,000 compared to $571,000 in fiscal 2005. Quarterly dividend payments were at the rate of $.03 per share throughout both fiscal 2006 and 2005. In fiscal 2006 dividend payments amounted to $384,000 compared to $379,000 in 2005 Exchange rate changes increased cash by $292,000 in fiscal 2006 compared to a decrease of $149,000 last year. In fiscal 2006 cash balances increased by

$160,000, compared to an increase of $225,000 in 2005. The main changes in operating assets and liabilities in fiscal 2006 were an increase in inventories of $980,000, and lower accounts payable of $202,000. Accounts receivable decreased by $6,000, accrued expenses increased by $16,000 and accrued income taxes were $34,000 higher than last year.

In September 2006 the Company adopted the provisions of SFAS #158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans". This did not impact on liquidity but did result in a decrease in stockholders' equity of $1,923,000 as the funded status of the Company's pension plans was recorded in the balance sheet.

The Company has no long-term debt and has overdraft facilities in the United Kingdom (UK) amounting to $2,055,000 and in France of $127,000. These facilities were unused at September 30, 2006 and September 30, 2005. The UK overdraft facilities are secured by all of the Company's assets in the UK and are due for renewal in September 2007 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 2007 but, in line with normal practice in Europe, can be withdrawn on demand by the bank.

At September 30, 2006 the Company's cash balances were $1,290,000 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 $96,000 per quarter in fiscal 2006. 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 $649,000. There were no significant capital expenditure commitments at September 30, 2006. 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, 2006:

(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	2,583	224	412	412	1,535
Purchase Obligations	2,633	2,633	-	-	-
Other long term liabilities	56	-	-	56	-
Total	$ 5,272	$ 2,857	$ 412	$ 468	$ 1,535

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 under Item 8 and other risks are described under the caption Risk Factors in Item 1A above.

Foreign currency risk

The Company sells to customers throughout the industrialized world. In fiscal 2006 approximately 42% of the Company's sales were made in US Dollars, 15% were made in British Pounds and 43% were made in Euros. The majority of the Company's products are assembled in the United Kingdom and approximately 75% 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.

Where appropriate, 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, 2006 was 8%, and amounted to $19,000, 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, 2006 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, 2006 and 2005

(in thousands of dollars except per share data)

ASSETS		**2006**		2005
Current assets:				
Cash and cash equivalents	**$**	**1,290**	$	1,130
Receivables, net of allowances for doubtful accounts of $141 in 2006 and $144 in 2005		**6,187**		6,193
Inventories		**4,717**		3,737
Prepaid expenses and other current assets		**847**		915
Total current assets		**13,041**		11,975
Property, plant and equipment, at cost:				
Land and improvements		**26**		25
Buildings and improvements		**2,256**		2,139
Equipment		**8,215**		7,429
		10,497		9,593
Less: accumulated depreciation and amortization		**7,202**		6,557
Net property, plant and equipment		**3,295**		3,036
Long-term deferred tax asset		**881**		-
Goodwill		**1,435**		1,435
Total assets	**$**	**18,652**	$	16,446

LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Accounts payable	**$**	**2,397**	$	2,599
Dividend payable		**96**		95
Accrued expenses		**2,701**		2,685
Accrued taxes on income		**479**		445
Total current liabilities		**5,673**		5,824
Deferred taxes on income		**-**		33
Liability for pension benefits		**2,886**		-
Other long term liabilities		**56**		-
Total liabilities		**8,615**		5,857
Commitments and contingencies (note 5)				
Stockholders' equity				
Preferred stock, par value $.10 per share - authorized - 1,000,000 shares; outstanding - none		**-**		-
Common stock, par value $.10 per share - authorized - 8,000,000 shares; outstanding 3,211,051 shares in 2006 and 3,172,051 shares in 2005		**321**		317
Premium paid in on common stock		**4,309**		4,310
Retained earnings		**7,123**		6,394
Unearned compensation on restricted stock		**-**		(180)
Cumulative other comprehensive loss		**(1,716)**		(252)
Total stockholders' equity		**10,037**		10,589
Total liabilities and stockholders' equity	**$**	**18,652**	$	16,446

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

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

For the Years ended September 30, 2006, 2005 and 2004

(in thousands except per share data)

		2006		2005		2004
Net sales	**$**	**34,630**	$	31,675	$	29,150
Cost of sales		**21,524**		19,639		17,605
Gross profit		**13,106**		12,036		11,545
Selling, research and administrative expenses		**11,262**		11,037		10,573
Operating income		**1,844**		999		972
Interest expense		**(64)**		(56)		(29)
Interest income		**6**		4		1
Foreign currency gain or (loss)		**(52)**		4		(26)
Income before income taxes		**1,734**		951		918
Income taxes		**(620)**		(310)		(307)
Net income	**$**	**1,114**	$	641	$	611
Basic income per share	**$**	**.35**	$	.21	$	.20
Diluted income per share	**$**	**.35**	$	.20	$	.19

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

For the Years ended September 30, 2006, 2005 and 2004

(in thousands of dollars)

		2006		2005		2004
Net income	**$**	**1,114**	$	641	$	611
Foreign currency translation adjustment		**459**		(208)		574
Changes in fair market value of cash flow hedges		**-**		(15)		6
Comprehensive income	**$**	**1,573**	$	418	$	1,191

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

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

For the Years ended September 30, 2006, 2005 and 2004

(in thousands of dollars except per share data)