

RAYOVAC CORP  
Form 10-Q  
February 11, 2004

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended December 28, 2003

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 001-13615

**Rayovac Corporation**

(Exact name of registrant as specified in its charter)

**Wisconsin**  
(State or other jurisdiction of  
incorporation or organization)

**22-2423556**  
(I.R.S. Employer  
Identification Number)

**601 Rayovac Drive, Madison, Wisconsin**  
(Address of principal executive offices)

**53711**  
(Zip Code)

**(608) 275-3340**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report.)

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Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

The number of shares outstanding of the Registrant's common stock, \$.01 par value, as of February 6, 2004, was 34,077,032.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

**RAYOVAC CORPORATION**  
**Condensed Consolidated Balance Sheets**  
December 28, 2003 and September 30, 2003  
(Unaudited)  
(In thousands)

	<u>December 28, 2003</u>	<u>September 30, 2003</u>
<b>-ASSETS-</b>		
Current assets:		
Cash and cash equivalents	\$ 25,637	\$ 107,774
Receivables, less allowances of \$36,363 and \$22,911, respectively	356,464	270,581
Inventories	178,895	219,254
Prepaid expenses and other	74,296	77,717
	<u>635,292</u>	<u>675,326</u>
Property, plant and equipment, net	148,727	150,609
Goodwill	406,940	398,380
Intangible assets, net	263,830	252,870
Deferred charges and other	66,858	71,196
Debt issuance costs	26,280	28,111
	<u>1,547,927</u>	<u>1,576,492</u>
<b>Total assets</b>	<b>\$ 1,547,927</b>	<b>\$ 1,576,492</b>
<b>-LIABILITIES AND SHAREHOLDERS' EQUITY-</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 15,184	\$ 72,852
Accounts payable	166,997	172,632
Accrued liabilities	210,181	160,041
	<u>392,362</u>	<u>405,525</u>
<b>Total current liabilities</b>	<b>392,362</b>	<b>405,525</b>
Long-term debt, net of current maturities	814,093	870,540
Employee benefit obligations, net of current portion	64,545	63,044
Other	38,667	35,381
	<u>1,309,667</u>	<u>1,374,490</u>
<b>Total liabilities</b>	<b>1,309,667</b>	<b>1,374,490</b>
Shareholders' equity:		
Common stock, \$.01 par value, authorized 150,000 shares; issued 62,484 and 61,999 shares, respectively; outstanding 32,948 and	625	620

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	December 28, 2003	September 30, 2003
32,463 shares, respectively		
Additional paid-in capital	192,374	185,561
Retained earnings	186,902	164,703
Accumulated other comprehensive loss	(955)	(12,457)
Notes receivable from officers/shareholders	(3,605)	(3,605)
	375,341	334,822
Less treasury stock, at cost, 29,536 shares	(130,070)	(130,070)
Less unearned restricted stock compensation	(7,011)	(2,750)
<b>Total shareholders' equity</b>	<b>238,260</b>	<b>202,002</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,547,927</b>	<b>\$ 1,576,492</b>

See accompanying notes which are an integral part of these statements.

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**RAYOVAC CORPORATION**  
**Condensed Consolidated Statements of Operations**

For the three month periods ended December 28, 2003 and December 29, 2002  
(Unaudited)  
(In thousands, except per share amounts)

	THREE MONTHS	
	2004	2003
Net sales	\$ 454,010	\$ 260,222
Cost of goods sold	260,980	156,963
Restructuring and related charges		9,705
Gross profit	193,030	93,554
Selling	101,443	51,609
General and administrative	36,513	21,821
Research and development	4,302	3,896
Restructuring and related charges	1,100	5,685
<b>Total operating expenses</b>	<b>143,358</b>	<b>83,011</b>
Operating income	49,672	10,543
Interest expense	17,351	10,102
Non-operating expense		3,072
Other income, net	(1,262)	(1,687)
Income (loss) from continuing operations before income taxes	33,583	(944)

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	<b>THREE MONTHS</b>	
	<b>2004</b>	<b>2003</b>
Income tax expense (benefit)	12,761	(359)
Income (loss) from continuing operations	20,822	(585)
Income from discontinued operations, net of tax of \$530	1,377	
Net income (loss)	\$ 22,199	\$ (585)
<b>Basic earnings per share:</b>		
Weighted average shares of common stock outstanding	32,168	31,801
Income (loss) from continuing operations	\$ 0.65	\$ (0.02)
Income from discontinued operations	0.04	
Net income (loss)	\$ 0.69	\$ (0.02)
<b>Diluted earnings per share:</b>		
Weighted average shares and equivalents outstanding	33,260	31,801
Income (loss) from continuing operations	\$ 0.63	\$ (0.02)
Income from discontinued operations	0.04	
Net income (loss)	\$ 0.67	\$ (0.02)

*See accompanying notes which are an integral part of these statements.*

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**RAYOVAC CORPORATION**  
**Condensed Consolidated Statements of Cash Flows**

For the three month periods ended December 28, 2003 and December 29, 2002  
(Unaudited)  
(In thousands)

	<b>THREE MONTHS</b>	
	<b>2004</b>	<b>2003</b>
Cash flows from operating activities:		
Net income (loss)	\$ 22,199	\$ (585)
Non-cash adjustments to net income:		
Discontinued operations	(1,377)	
Depreciation	8,313	8,286
Amortization	216	63
Amortization of debt issuance costs	1,005	460
Other non-cash adjustments	(350)	3,791
Net changes in assets and liabilities, net of acquisitions and discontinued operations	17,320	12,211

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	<b>THREE MONTHS</b>	
	<b>2003</b>	<b>2002</b>
Net cash provided by continuing operating activities	47,326	24,226
<b>Cash flows from investing activities:</b>		
Purchases of property, plant and equipment	(2,955)	(3,052)
Proceeds from sale of property, plant and equipment		113
Payment for acquisitions, net of cash acquired	(2,577)	(245,130)
<b>Net cash used by investing activities</b>	<b>(5,532)</b>	<b>(248,069)</b>
<b>Cash flows from financing activities:</b>		
Reduction of debt	(147,158)	(257,803)
Proceeds from debt financing	76,500	506,771
Extinguishment of debt	(57,012)	
Debt issuance costs		(12,635)
Other	1,913	(606)
<b>Net cash (used) provided by financing activities</b>	<b>(125,757)</b>	<b>235,727</b>
Net cash provided by discontinued operations	924	
Effect of exchange rate changes on cash and cash equivalents	902	1,154
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(82,137)</b>	<b>13,038</b>
Cash and cash equivalents, beginning of period	107,774	9,881
<b>Cash and cash equivalents, end of period</b>	<b>\$ 25,637</b>	<b>\$ 22,919</b>

*See accompanying notes which are an integral part of these statements.*

**RAYOVAC CORPORATION**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**(In thousands, except per share amounts)**

**1 SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation:** These financial statements have been prepared by Rayovac Corporation (the "Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") and, in the opinion of the Company, include all adjustments (which are normal and recurring in nature) necessary to present fairly the financial position of the Company at December 28, 2003, and the results of operations and cash flows for the three month periods ended December 28, 2003 and December 29, 2002. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such SEC rules and regulations. These condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto as of September 30, 2003. Certain prior year amounts have been reclassified to conform with the current presentation.

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**Significant Accounting Policies and Practices:** The consolidated financial statements include the financial statements of Rayovac Corporation and its subsidiaries and are prepared in accordance with accounting principles generally accepted in the United States of America. All intercompany transactions have been eliminated. The Company's fiscal year ends September 30. References herein to 2003 and 2004 refer to the fiscal years ended September 30, 2003 and 2004.

The Company's Condensed Consolidated Balance Sheet as of September 30, 2003 gives effect to the acquisition of Remington Product Company, L.L.C., "Remington", which occurred on September 30, 2003. The Company's Condensed Consolidated Statement of Operations for the three months ended December 29, 2002, includes only the results attributable to Rayovac and its subsidiaries prior to the Remington acquisition. Consequently, all Condensed Consolidated Statement of Operations footnote disclosures exclude the results of Remington for the three months ended December 29, 2002. See footnote 10, Acquisitions, for additional information on the Remington acquisition.

**Discontinued Operations:** The Company has reflected Remington's United States and United Kingdom Service Centers as discontinued operations. The Company will discontinue operations at these Service Centers during 2004 as part of our Remington integration initiatives. See footnote 8, Restructuring and Related Charges, and footnote 11, Subsequent Events, for additional discussion of Remington integration initiatives. The following amounts have been segregated from continuing operations and are reflected as discontinued operations for the three months ended December 28, 2003:

Net sales	\$ 13,647
Income from discontinued operations before income taxes	1,907
Provision for income taxes	530
Income from discontinued operations, net of tax	\$ 1,377
Depreciation expense associated with discontinued operations	\$ 133

**Revenue Recognition:** The Company recognizes revenue from product sales upon shipment to the customer which is the point at which all risks and rewards of ownership of the product are passed, provided that: there are no uncertainties regarding customer acceptance; persuasive evidence of an

arrangement exists; the price to the buyer is fixed or determinable; and collectibility is deemed reasonably assured. The Company is generally not obligated to allow for, and the Company's general policy is not to accept, product returns. The Company does recognize a reserve for potential returns, when appropriate, based on past experience and our latest contractual arrangements with certain customers.

The Company enters into various promotional arrangements, primarily with retail customers, including arrangements entitling such retailers to cash rebates from the Company based on the level of their purchases, which require the Company to estimate and accrue the estimated costs of the promotional programs. These costs are generally treated as a reduction of net sales.

The Company also enters into promotional arrangements targeted to the ultimate consumer. Such arrangements are treated as either a reduction of net sales or an increase of cost of sales, based on the type of promotional program. The income statement characterization of the Company's promotional arrangements complies with EITF 01-09, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*.

For all types of promotional arrangements and programs, the Company monitors its commitments and uses statistical measures and past experience to determine amounts to be recorded for the estimate of the earned, but unpaid, promotional costs. The terms of the Company's customer-related promotional arrangements and programs are individualized to each customer and are generally documented through written contracts, correspondence or other communications with the individual customers.

The Company also enters into various contractual arrangements, primarily with retail customers, which require the Company to make upfront cash, or "slotting" payments, to secure the right to distribute through such customer. The Company capitalizes slotting payments, provided the payments are supported by a time or volume based contractual arrangement with the retailer, and will amortize the associated payment over the appropriate time or volume based term of the contractual arrangement. The amortization of the slotting payment is treated as a reduction in net sales and the corresponding asset is included in Deferred charges and other in the Condensed Consolidated Balance Sheets.

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**Shipping and Handling Costs:** The Company incurred shipping and handling costs of \$18,288 and \$12,996 for the three months ended December 28, 2003 and December 29, 2002, respectively, which are included in selling expense. Shipping and handling costs include costs incurred with third-party carriers to transport products to customers and salaries and overhead costs related to activities to prepare the Company's products for shipment at the Company's distribution facilities.

**Concentrations of Credit Risk:** Trade receivables potentially subject the Company to credit risk. The Company extends credit to its customers based upon an evaluation of the customer's financial condition and credit history and generally does not require collateral. The Company monitors its customers' credit and financial condition based on changing economic conditions and will make adjustments to credit policies as required. The Company has historically incurred minimal credit losses, but in 2002 experienced a significant loss resulting from the bankruptcy filing of a large retailer in the United States.

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The Company has a broad range of customers including many large retail outlet chains, one of which accounts for a significant percentage of our sales volume. This major customer also represented approximately 19% and 13%, respectively, of our receivables as of December 28, 2003 and September 30, 2003.

Following the acquisition of Remington, approximately 49% of the Company's sales occur outside of North America. These sales and related receivables are subject to varying degrees of credit, currency, and political and economic risk. The Company monitors these risks and makes appropriate provisions for collectibility based on an assessment of the risks present.

**Stock Based Compensation:** The Company has stock option and other stock-based compensation plans, which are fully described in the Company's financial statements and notes thereto as of September 30, 2003. The Company accounts for its stock-based compensation plans using the intrinsic value method, under the principles prescribed by the Accounting Principles Board's Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. For stock options granted, no employee compensation cost is reflected in the Company's results of operations, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock at the grant date. Results of operations include compensation cost related to grants of restricted stock of \$912 and \$833 for the three months ended December 28, 2003 and December 29, 2002, respectively.

The Company has adopted the disclosure-only provisions of FASB Statement No. 123, ("Statement No. 123") *Accounting for Stock Based Compensation*, as amended by FASB Statement No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure*. Accordingly, no compensation cost has been recognized in the results of operations for the stock option plans. Had compensation cost for stock options granted been determined based on the fair value at the grant date for awards consistent with an alternative method prescribed by Statement No. 123, the Company's net income (loss) and earnings per share would have reflected the pro forma amounts indicated below:

	Three Months	
	2004	2003
Net income (loss), as reported	\$ 22,199	\$ (585)
Add: Stock-based compensation expense included in reported net income, net of tax	556	508
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of tax	(1,515)	(1,855)
Pro forma net income (loss)	\$ 21,240	\$ (1,932)
<b>Basic earnings per share:</b>		
Net income (loss), as reported	\$ 0.69	\$ (0.02)
Net income (loss), Pro forma	\$ 0.66	\$ (0.06)
<b>Diluted earnings per share:</b>		
Net income (loss), as reported	\$ 0.67	\$ (0.02)

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Three Months

Net income (loss), Pro forma

Three Months	
\$ 0.64	\$ (0.06)

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The effect of restricted stock and unexercised stock options of approximately 712 shares outstanding for the three-month period ended December 29, 2002 were excluded from the diluted EPS calculation, as their effect was anti-dilutive.

**Derivative Financial Instruments:** The Company uses interest rate swaps to manage its interest rate risk. The swaps are designated as cash flow hedges with the fair value recorded in Other Comprehensive Income ("OCI") and as a hedge asset or liability, as applicable. The swaps settle periodically in arrears with the related amounts for the current settlement period payable to, or receivable from, the counter-parties included in accrued liabilities or accounts receivable and recognized in earnings as an adjustment to interest expense from the underlying debt to which the swap is designated. During the three month periods ended December 28, 2003 and December 29, 2002, respectively, \$1,220 and \$1,078 of pretax derivative losses from such hedges were recorded as an adjustment to interest expense. At December 28, 2003, the Company had a portfolio of interest rate swaps outstanding which effectively fixes the interest rates on floating rate debt at rates as follows: 4.458% for a notional principal amount of \$70,000 through July 2004, 3.974% for a notional principal amount of \$70,000 from July 2004 through October 2005, 3.769% for a notional principal amount of \$100,000 through August 2004 and 3.799% for a notional principal amount of \$100,000 from August 2004 through November 2005. The derivative net loss on these contracts recorded in OCI at December 28, 2003 and December 29, 2002, respectively, was an after-tax loss of \$3,615 and \$4,814.

The Company enters into forward and swap foreign exchange contracts, to hedge the risk from forecasted settlement in local currencies of inter-company purchases and sales, trade sales, and trade purchases. These contracts generally require the Company to exchange foreign currencies for U.S. dollars, Euros or Pounds Sterling. These contracts are designated as cash flow hedges with the fair value recorded in OCI and as a hedge asset or liability, as applicable. Once the forecasted transaction has been recognized as a purchase or sale and a related liability or asset recorded in the balance sheet, the gain or loss on the related derivative hedge contract is reclassified from OCI into earnings as an offset to the change in value of the liability or asset. During the three month periods ended December 28, 2003 and December 29, 2002, respectively, \$0 and \$11 of pretax derivative losses were recorded as an adjustment to earnings for forward and swap contracts settled at maturity. At December 28, 2003 and December 29, 2002, respectively, the Company had no such foreign exchange derivative contracts outstanding.

The Company periodically enters into forward and swap foreign exchange contracts, to hedge the risk from inter-company loans. These obligations generally require the Company to exchange foreign currencies for U.S. dollars, Euros, Pounds Sterling or Canadian Dollars. These foreign exchange contracts are fair value hedges of a related liability or asset recorded in the balance sheet. The gain or loss on the derivative hedge contracts is recorded in earnings as an offset to the change in value of the related liability or asset. During the three month period ended December 28, 2003, \$94 of pretax derivative gains from such hedges were recorded as an adjustment to earnings. At December 28, 2003, the Company had such forward and swap contracts outstanding with a contract value of \$7,023. No such forward and swap foreign exchange contracts were outstanding at December 29, 2002.

The Company periodically enters into forward foreign exchange contracts, to hedge the risk from changes in fair value from unrecognized firm purchase commitments. These firm purchase commitments generally require the Company to exchange U.S. dollars for foreign currencies. These

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hedge contracts are designated as fair value hedges with the fair value recorded in earnings on a pretax basis and as a hedge asset or liability, as applicable. To the extent effective, changes in the value of the forward contracts recorded in earnings will be offset by changes in the value of the hedged item, also recorded in earnings on a pretax basis and as an asset or liability, as applicable. Once the firm purchase commitment has been consummated, the firm commitment asset or liability balance will be reclassified as an addition to or subtraction from, the carrying value of the purchased asset. During the three month periods ended December 28, 2003 and December 29, 2002, respectively, no such foreign exchange derivative activity occurred. At December 28, 2003 and December 29, 2002, respectively, the Company had no such foreign exchange derivative contracts outstanding.

The Company is exposed to risk from fluctuating prices for zinc used in the manufacturing process. The Company hedges a portion of this risk through the use of commodity swaps. The swaps are designated as cash flow hedges with the fair value recorded in OCI and as a hedge asset



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or liability, as applicable. The fair value of the swaps is reclassified from OCI into earnings when the hedged purchase of zinc metal-based items also affects earnings. The swaps effectively fix the floating price on a specified quantity of zinc through a specified date. During the three month periods ended December 28, 2003 and December 29, 2002, respectively, \$232 of pretax derivative gains and \$218 of pretax derivative losses were recorded as an adjustment to cost of sales for swap contracts settled at maturity. At December 28, 2003, the Company had a series of such swap contracts outstanding through October 2004 with a contract value of \$7,351. The derivative net gain or loss on these contracts recorded in OCI at December 28, 2003 and December 29, 2002, respectively, was an after-tax gain of \$1,071 and an after-tax loss of \$217.

**Change in Accounting Policy:** In previous years, the Company deferred certain advertising costs incurred on an interim basis in accordance with APB 28. The Company chose the deferral method to match advertising expenses to the level of sales on an interim basis (i.e., more advertising expenses were recognized in quarters in which the level of sales was higher) as management believed that the benefits of the advertising expenditures extended beyond the interim period in which the expenditures were made. However, in the Company's annual financial statements, there was no deferral of advertising costs incurred and the Company recognized advertising costs in accordance with the American Institute of Certified Public Accountants' Statement of Position No. 93-7, *Reporting on Advertising Costs*. The acquisition of Remington on September 30, 2003, will result in an increased level of advertising expenditures required for Remington's personal care products, as well as expenses that are more seasonal in nature, as compared to the Company's legacy battery products. Therefore, beginning with the three months ended December 28, 2003, the Company began expensing all advertising costs in the period in which they are incurred for interim reporting purposes. This change has no impact on the reported results for prior years. Management believes the new policy of expensing all advertising expenses as incurred is preferable as it eliminates the uncertainty in estimating overall expected net sales and the benefit period of the advertising on an interim basis. In addition, the new accounting policy results in the recognition of advertising costs in the interim period in which they are actually incurred, and conforms the Company's interim accounting policy with that used to prepare the

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annual financial statements. The impacts on net income (loss) and earnings per share related to the change in accounting policy is as follows:

	<b>Three Months</b>	
	<b>2004</b>	<b>2003</b>
Income (loss) before change in accounting policy	\$ 25,423	\$ (585)
Less: Impact due to change in accounting policy, net of tax		(3,224)
<b>Net income (loss), as reported</b>	<b>\$ 22,199</b>	<b>\$ (585)</b>
<b>Basic earnings per share:</b>		
Income (loss) before change in accounting policy	\$ 0.79	\$ (0.02)
Less: Impact due to change in accounting policy, net of tax		(0.10)
<b>Net income (loss), as reported</b>	<b>\$ 0.69</b>	<b>\$ (0.02)</b>
<b>Diluted earnings per share:</b>		
Income (loss) before change in accounting policy	\$ 0.76	\$ (0.02)
Less: Impact due to change in accounting policy, net of tax		(0.09)
<b>Net income (loss), as reported</b>	<b>\$ 0.67</b>	<b>\$ (0.02)</b>

Had the prior year's advertising expense been recognized consistent with the policy used in the current fiscal year, the Company's net income (loss) and earnings per share would have reflected the pro forma amounts indicated below:

<b>Three Months</b>	
<b>2004</b>	<b>2003</b>

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Three Months

Pro forma amounts assuming new accounting policy is applied retroactively:

Net income (loss)	\$ 22,199	\$ (3,251)
Basic earnings (loss) per share	\$ 0.69	\$ (0.10)
Diluted earnings (loss) per share	\$ 0.67	\$ (0.10)

The effect of restricted stock and unexercised stock options of approximately 712 shares outstanding for the three-month period ended December 29, 2002 were excluded from the diluted EPS calculation, as their effect was anti-dilutive.

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2 INVENTORIES

Inventories consist of the following:

	December 28, 2003	September 30, 2003
Raw material	\$ 34,717	\$ 60,732
Work-in-process	20,355	34,914
Finished goods	123,823	123,608
	\$ 178,895	\$ 219,254

3 ACQUIRED INTANGIBLE ASSETS AND GOODWILL

Intangible assets consist of the following:

	December 28, 2003			September 30, 2003		
	Gross Carrying Amount	Accumulated Amortization	Net Intangible	Gross Carrying Amount	Accumulated Amortization	Net Intangible
<b>Amortized Intangible Assets:</b>						
Proprietary technology	\$ 10,421	\$ 514	\$ 9,907	\$ 10,421	\$ 340	\$ 10,081
Customer lists	1,781	252	1,529	1,781	210	1,571
Effect of translation			2,989			2,084
			\$ 14,425			\$ 13,736
<b>Pension Intangibles</b>						
Under-funded pension	\$ 2,405	\$ 2,405	\$ 2,405	\$ 2,405	\$ 2,405	\$ 2,405
<b>Unamortized Intangible Assets</b>						
Trade names balance as of beginning of the period	\$ 218,642	\$ 4,875	\$ 213,767	\$ 90,000	\$ 4,875	\$ 85,125
Trade name acquired during the period				128,642		128,642
Subtotal			213,767			213,767

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	December 28, 2003			September 30, 2003
Effect of translation	33,233			22,962
Trade names balance as of end of period	\$ 247,000			\$ 236,729
<b>Goodwill</b>	<b>North America</b>	<b>Latin America</b>	<b>Europe/ROW</b>	<b>Total</b>
Balance as of September 30, 2003, net	\$ 285,418	\$ 37,876	\$ 75,086	\$ 398,380
Goodwill recognized during the period	3,936			

PROPOSAL  
2:  
APPROVAL  
OF AN  
INCREASE  
IN THE  
NUMBER  
OF SHARES  
ISSUABLE  
UNDER THE  
1996  
EQUITY  
INCENTIVE  
PLAN

General

The Company is seeking stockholder approval of an amendment to its 1996 Equity Incentive Plan (the "Equity Plan") to increase the number of shares of common stock authorized for issuance by 250,000.

The purpose of the Equity Plan is to attract and retain key employees and consultants of the Company, to provide them an incentive to achieve long-range performance goals and to enable them to participate in the Company's long-term growth. The Equity Plan also serves to align the interests of non-employee directors with those of the stockholders by increasing the directors' proprietary interest in the Company's growth and success, since a portion of the directors' compensation is paid in the form of shares. This helps attract and retain well-qualified persons to serve as directors.

Grants that have been made to date under the Equity Plan are described under "Plan Benefits" below, and details about recent grants are provided under "Corporate Governance – Director Compensation" and "Executive Compensation – Compensation Tables" below. As of December 9, 2015, 139,578 shares remained available for grant. If approved, the increase of 250,000 shares, combined with the 139,578 still available, would be equivalent to 10.5% of the Company's 3,694,872 shares presently outstanding. The Company expects to use the additional authorized shares for continued periodic equity grants to key employees, directors and consultants. As of December 9, 2015, 11 key employees and nine non-employee directors were eligible for awards under the Equity Plan.

The Equity Plan is administered by a committee (the "Committee") of not less than three members of the Board of Directors, currently the Compensation Committee. The Committee may make awards to the Company's employees, directors, directors emeritus and consultants based on their past or anticipated contributions to the achievement of the Company's objectives and other relevant matters.

The Board of Directors believes that the shares issuable under the Equity Plan should be increased in order to ensure

that a sufficient number of shares are available to be issued under the Equity Plan in the future in order to provide appropriate equity incentives to attract, motivate and retain key employees, directors and consultants of the Company.

#### Shares Subject to Awards

Assuming approval of this proposal, 389,578 shares will be available for awards under the Equity Plan. The number and kind of shares available are subject to adjustment to reflect stock dividends, recapitalizations or other changes affecting the Company's Common Stock. If any outstanding or future award expires or is terminated unexercised or settled in a manner that results in fewer shares outstanding than were initially awarded, the shares which would have been issuable will again be available for award under the Equity Plan.

## Description of Awards

The Equity Plan provides for the following basic types of awards:

**Restricted Stock.** The Committee may grant shares of Common Stock that are only earned if specified conditions, such as a completing a term of employment or satisfying pre-established performance goals, are met and that are otherwise subject to forfeiture.

**Restricted Stock Units.** The Committee may grant the right to receive shares of Common Stock in the future, also based on meeting specified conditions and subject to forfeiture. These awards are to be made in the form of “units,” each representing the equivalent of one share of Common Stock, although they may be settled in either cash or stock. Restricted stock unit awards represent an unfunded and unsecured obligation of the Company. In the discretion of the Committee, units may be awarded with rights to the payment of dividend equivalents.

**Stock Options.** The Committee may grant options to purchase shares of Common Stock that are either incentive stock options (ISOs) eligible for the special tax treatment described below or nonstatutory stock options. No option may have an exercise price that is less than the fair market value of the Common Stock on the date of grant, and no ISO may have a term of more than ten years. An option may be exercised by the payment of the option price in cash or with such other lawful consideration as the Committee may determine, including by delivery of a note (other than for a director or executive officer) or shares of Common Stock valued at their fair market value on the date of delivery.

**Stock Appreciation Rights.** The Committee may grant Stock Appreciation Rights (SARs), under which the participant receives cash, shares of Common Stock or other property, or a combination thereof, as determined by the Committee, equal in value to the difference between the exercise price of the SAR and the fair market value of the Common Stock on the date of exercise. SARs may be granted in tandem with options (at or after award of the option) or alone and unrelated to an option. SARs in tandem with an option terminate to the extent that the related option is exercised, and the related option terminates to the extent that the tandem SAR is exercised. The exercise price of an SAR may not be less than the fair market value of the Common Stock on the date of grant or in the case of a tandem SAR, the exercise price of the related option.

Awards under the Equity Plan contain such terms and conditions consistent with the Equity Plan as the Committee in its discretion approves. The Committee has discretion to administer the Equity Plan in the manner which it determines, from time to time, is in the best interest of the Company. For example, the Committee will fix the terms of stock options, SARs and restricted stock grants and determine whether, in the case of options and SARs, they may be exercised immediately or at a later date or dates. Awards may be granted subject to conditions relating to continued employment, achievement of performance goals and restrictions on transfer. The Committee may provide, at the time an award is made or at any time thereafter, for the acceleration of a participant's rights or cash settlement upon a change in control of the Company. All options and restricted stock awards granted to date provide for the acceleration of vesting in the event of a change in control of the Company. The terms and conditions of awards need not be the same for each participant. The foregoing examples illustrate, but do not limit, the manner in which the Committee may exercise its authority in administering the Equity Plan.

The maximum aggregate number of shares subject to all awards that may be granted to a participant in any calendar year is 60,000 shares, subject to adjustment for changes in capitalization. Incorporation of this limit is intended to qualify the awards as performance-based compensation that is not subject to the Section 162(m) \$1 million limit on deductibility for federal income tax purposes of compensation paid to certain senior officers, as further discussed below.

## Amendment of Equity Plan

The Board may amend the Equity Plan subject to any stockholder approval required to comply with any applicable tax or regulatory requirement. The Committee has authority to amend outstanding awards, including changing the date of exercise and converting an incentive stock option to a nonstatutory option, if the Committee determines that such action would not adversely affect the participant.

U.S. Federal Income Tax Consequences Relating to Awards under the Equity Plan

The following discussion summarizes certain U.S. federal income tax consequences of awards under the Equity Plan based on the law as in effect on the date of this proxy statement. It does not purport to cover federal employment taxes or other federal tax consequences that may be associated with awards, nor does it cover state, local or non-U.S. taxes.

**Incentive Stock Options.** A participant does not realize taxable income upon the grant or exercise of an ISO under the Equity Plan. If a participant does not dispose of shares received upon exercise of an ISO for at least two years from the date of grant and one year from the date of exercise, then (1) upon sale of the shares, any amount realized in excess of the exercise price is taxed to the participant as long-term capital gain and any loss sustained will be a long-term capital loss and (2) the Company may not take a deduction for federal income tax purposes. The exercise of ISOs gives rise to an adjustment in computing alternative minimum taxable income that may result in alternative minimum tax liability for the participant.

If shares of Common Stock acquired upon the exercise of an ISO are disposed of before the end of the one and two-year periods described above (a “disqualifying disposition”), the participant realizes ordinary income in the year of disposition in an amount equal to the excess (if any) of the fair market value of the shares at exercise (or, if less, the amount realized on a sale of such shares) over the exercise price. The Company would be entitled to a tax deduction for the same amount. Any further gain realized by the participant would be taxed as a short-term or long-term capital gain and would not result in any deduction for the Company. A disqualifying disposition in the year of exercise will generally avoid the alternative minimum tax consequences of the exercise of an ISO.

**Nonstatutory Stock Options and Stock Appreciation Rights.** No income is realized by the participant upon the grant of a nonstatutory option or stock appreciation right. Upon exercise, the participant realizes ordinary income in an amount equal to the difference between the exercise price and the fair market value of the shares on the date of exercise. The Company would receive a tax deduction for the same amount. In the case of stock options or stock-settled stock appreciation rights, appreciation or depreciation after the date of exercise is treated as a short-term or long-term capital gain or loss and will not result in any further tax deduction by the Company. The ordinary income recognized with respect to the receipt of shares upon exercise of a nonstatutory option or stock appreciation right will be subject to applicable wage withholding and other employment taxes.

**Restricted Stock.** Generally, a participant will be taxed at the time the restrictions on the shares lapse without a forfeiture. The excess of the fair market value of the shares at that time over the amount paid, if any, by the participant for the shares will be treated as ordinary income. The participant may instead elect under Section 83(b) of the U.S. tax code within 30 days after the date of the grant to be taxed (as ordinary income) on the date of grant on the excess of the then fair market value of the shares over the amount paid, if any, for the shares. If the shares subject to the Section 83(b) election are subsequently forfeited, the recipient will not be entitled to any deduction, refund or loss for tax purposes. In either case, the Company would receive a tax deduction for the amount reported as ordinary income to the participant. Upon the participant’s disposition of the shares, any subsequent appreciation or depreciation is treated as a short or long-term capital gain or loss and will not result in any further tax deduction by the Company.

**Restricted Stock Units.** A participant will generally realize ordinary income in an amount equal to the fair market value of the shares (or the amount of cash) distributed to settle the restricted stock units at the time of settlement, which is generally upon vesting of the restricted stock units. In certain limited circumstances, a settlement date may be later than the vesting date, in which case the settlement would be made in a manner intended to comply with the rules governing non-qualified deferred compensation arrangements. In either case, the Company would receive a corresponding tax deduction at the time of settlement. If the restricted stock units are settled in shares, then upon sale of those shares any subsequent appreciation or depreciation would be treated as short-term or long-term capital gain or loss to the participant and would not result in any further tax deduction by the Company.





#### Other Tax Matters.

Section 162(m). United States tax laws generally do not allow publicly-held companies to obtain tax deductions for compensation of more than \$1 million paid in any year to any of the Chief Executive Officer or three most highly paid executive officers other than the Chief Financial Officer (each, a “covered person”) unless the compensation is “performance-based” as defined in Section 162(m) of the U.S. tax code. Stock options and SARs granted under the Equity Plan are performance-based compensation if they have exercise prices not less than the fair value of Common Stock on the date of grant. In the case of restricted stock and restricted stock units, performance goals generally must be pre-established for the relevant performance period and satisfaction of any such performance goals must be certified by the Committee.

Section 162(m) also requires that the general business criteria of any performance goals that are established by the Committee be periodically reapproved by stockholders in order for such awards to be considered performance-based and to preserve the Company's federal income tax deductions that may become available to the Company when payments based on these performance goals are made to covered persons. The Equity Plan sets forth the following list of business criteria upon which the Committee may establish performance goals for deductible performance-based awards made to covered persons: (i) increases in the price of the Common Stock; (ii) market share; (iii) sales; (iv) revenue; (v) return on equity, assets, or capital; (vi) economic profit (economic value added); (vii) total shareholder return; (viii) costs; (ix) expenses; (x) margins; (xi) earnings or earnings per share; (xii) cash flow; (xiii) customer satisfaction; (xiv) operating profit; or (xv) any combination of the foregoing, including without limitation goals based on any of such measures relative to appropriate peer groups or market indices. Performance goals may be particular to a participant or may be based, in whole or in part, on the performance of the division, department, line of business, subsidiary, or other business unit in which the participant works, or on the performance of the Company generally.

Parachute Payment Tax. A participant who receives any accelerated vesting or exercise of options or stock appreciation rights or accelerated lapse of restrictions on restricted stock or restricted stock units in connection with a change in control might be deemed to have received an “excess parachute payment” under federal tax law. In such cases, the participant may be subject to an excise tax and the Company may be denied a tax deduction.

#### Plan Benefits

To date, the Committee has granted stock options and restricted stock under the Equity Plan in the following aggregate amounts to: (i) Matthew Boyle, President and Chief Executive Officer, 80,000 stock options, of which 76,000 have lapsed without being exercised, and 87,000 shares of restricted stock, (ii) Paul N. Farquhar, Vice President and Chief Financial Officer, 60,000 shares of restricted stock, (iii) all current executive officers as a group, 80,000 stock options, of which 76,000 have lapsed without being exercised, and 147,000 shares of restricted stock, (iv) all current non-employee directors as a group, 15,000 stock options, all of which have lapsed without being exercised, and 143,000 shares of restricted stock, and (v) all other current employees as a group, 23,500 stock options, of which 21,500 have lapsed without being exercised, and 187,000 shares of restricted stock.

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The following table sets out the status of shares authorized for issuance under equity compensation plans at September 30, 2015.

Plan Category	Number of securities to be issued upon exercise of outstanding options warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) at end of year (c)
Equity compensation plans approved by security holders:			
1996 Equity Incentive Plan	-	\$ -	139,578
Sub Total	-	\$ -	139,578
Equity compensation plans not approved by security holders	-	-	-
Total	-	\$ -	139,578

The closing price of the Company's common stock on the NASDAQ Capital Market on December 9, 2015 was \$ 9.75.

Vote Required

Approval of the increase in the number of shares of common stock authorized for issuance under the Equity Plan will require the affirmative vote of a majority of the votes cast at the annual meeting. Accordingly, abstentions and broker non-votes will not count as votes cast for or against this proposal.

The Board of Directors recommends that you vote FOR the approval of the increase.

PROPOSAL RATIFICATION OF THE SELECTION OF THE COMPANY'S INDEPENDENT REGISTERED  
3: PUBLIC ACCOUNTING FIRM FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 2016

RSM US LLP (formerly known as McGladrey LLP) has served as the Company's independent registered public accounting firm for the last four fiscal years. The Board of Directors is seeking an advisory stockholder vote ratifying the appointment of RSM US LLP as the Company's independent registered public accounting firm and expects to engage them for the fiscal year ending September 30, 2016. The Audit Committee believes RSM US LLP is well

qualified to continue as the Company's auditor.

Representatives of RSM US LLP are expected to attend the annual meeting and to be available to respond to appropriate questions. They will also have the opportunity to make a statement if they desire.

The fees billed by RSM US LLP and other member firms of the RSM International network, of which RSM US LLP is a member, for fiscal 2015 and 2014 are set out below. Such other firms assisted RSM US LLP with audit and tax work in respect of the Company's U.K. and China subsidiaries.

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	(in thousands)	
	2015	2014
	\$	\$
Audit fees	202	172
Tax fees	35	30
Total	237	202

The tax fees in 2015 and 2014 are for the preparation of the Company's tax returns in the United States and for preparation of the Company's UK subsidiaries' tax returns.

All of the above services and fees were approved by the Audit Committee before the respective engagements were undertaken. The Company has not adopted pre-approval policies and procedures relating to non-audit services.

#### Vote Required

Ratification of the appointment of RSM US LLP by the stockholders is not required by law or by the Company's by-laws. The Board of Directors is nevertheless submitting this non-binding resolution to the stockholders to ascertain their views. If this proposal is not approved at the annual meeting, the Audit Committee intends to reconsider its recommendation of RSM US LLP as independent auditors. The Company may retain the firm for fiscal 2016 notwithstanding a negative stockholder vote.

The ratification of the appointment of RSM US LLP will require the affirmative vote of a majority of the votes cast at the annual meeting. Accordingly, abstentions and broker non-votes will not count as votes cast for or against this proposal.

The Board of Directors recommends that you vote FOR the ratification of RSM US LLP's selection as the Company's independent registered public accounting firm for the fiscal year ending September 30, 2016.

#### PROPOSAL 4: ADVISORY VOTE REGARDING THE EXECUTIVE OFFICERS' COMPENSATION

This proposal, commonly known as "Say on Pay," asks the stockholders to approve the compensation of the Company's executive officers as described under "Executive Compensation" on pages 22 to 24 of this proxy statement.

The compensation paid to the Company's executive officers is intended to align their interests with the long-term interests of the Company's stockholders and is based on a pay-for-performance philosophy. It is straightforward, consisting principally of salary, which must be competitive to retain the skills and experience of excellent employees, an annual bonus to reward strong performance, and equity compensation to encourage long-term commitment and team performance. Not all elements may be provided every year, depending on the performance of the Company and the executive.

In 2015 the executives led the company into potential high value on-road markets, securing business in the Far East and Europe for the future. In addition the Company successfully penetrated new markets in agriculture and marine applications. The markets in which we operate continue to be volatile and still face a difficult economic environment. The Board believes that with the Company's executive leadership, we will continue to grow and prosper over the long term, that they merit their compensation and that it should be approved by the stockholders.

The vote on this proposal, which is solicited pursuant to section 14A of the Securities Exchange Act, is advisory and its outcome will not be binding on the Board nor require the Board to take any action. Moreover, the outcome of the vote will not be construed as overruling any decision of the Board, or creating or implying any additional fiduciary

duty of the Board. However, the Board expects to take into account the outcome of this vote when considering future executive compensation arrangements for the Company's executive officers. The Board has determined that the Company will include a stockholder vote on the compensation of its named executive officers in its proxy statement each year until the next required vote on the frequency of such votes. Accordingly, the next such vote will occur at the 2017 annual meeting of stockholders.

The proposal will be considered approved at the annual meeting if more votes are cast in favor than against. Abstentions and broker non-votes will not count as votes cast for or against this proposal.

The Board of Directors recommends a vote FOR approval of the compensation of the Company's named executive officers, as disclosed in this proxy statement.

## CORPORATE GOVERNANCE

### Director Independence

The Board has determined that all directors, other than Mr. Boyle, and the two shareholder nominees are independent under Securities and Exchange Commission rules and NASDAQ Capital Market listing standards, based on information known to the Company and on the annual questionnaire completed by each director and nominee. The Company may from time to time have arms-length commercial dealings with companies of which its directors may be officers and/or directors. To the Company's knowledge, during fiscal 2015, there were no such dealings and none of the independent directors or shareholder nominees had any other business, financial, family or other type of relationship with the Company or its management other than as a director and stockholder.

### Board Leadership Structure

The Company has always had different persons serving in the offices of Chairman of the Board and Chief Executive Officer (CEO), although it has no formal policy requiring that structure, and it is likely that the Board would elect an independent lead director if the Chairman and CEO were the same person. The responsibilities of the Chairman or lead director include chairing the Executive Committee, setting the Board's agenda in collaboration with the CEO, providing guidance to the CEO, acting as a regular communication channel between the Board and CEO, presiding over executive sessions of the Board to review the Company's performance and management effectiveness, coordinating the activities of the independent directors, reviewing the activities and effectiveness of the Board committees, and evaluating the need for any changes. The Board believes that having a separate Chairman or lead director allows the CEO to focus principally on managing the Company, which is important because of the Company's small senior management team, enhances Board involvement and communications among the independent directors, and would ensure consistent Board leadership during any CEO transition.

### Board Meetings

During the fiscal year ended September 30, 2015, the Board of Directors held a total of six meetings, as well as two interim update calls. The Board regularly holds meetings at which only independent directors are present. All Board members are expected to attend the annual meeting of stockholders, subject to special circumstances. All but one of the members of the Board at the time attended the annual meeting of stockholders in 2015.

### Communications to the Board

Stockholders may communicate with the Board of Directors by mailing a communication to the entire Board or to one or more individual directors, in care of the Corporate Secretary, Sevcon, Inc., 155 Northboro Road, Southborough, Massachusetts 01772. All communications from stockholders to Board members (other than communications soliciting the purchase of products and services) will be promptly relayed to the Board members to whom the communications are addressed.

### Committees of the Board

The Board of Directors has an Audit Committee, a Compensation Committee and a Nominating and Governance Committee, all the members of which are independent under Securities and Exchange Commission rules and

NASDAQ Capital Market listing standards, as applicable. In addition to the meetings described below, the members of each committee communicate regularly amongst themselves and with management on Company matters.

Each of the Audit Committee, the Compensation Committee and the Nominating and Governance Committee operates under a written charter that is available on the Company's web site: [www.sevcon.com](http://www.sevcon.com).

#### Audit Committee

The Audit Committee is composed of five directors. The Board has determined that at least three of the members of the Committee, Messrs. Angiolillo, Hemsley and Ketelhut, are “audit committee financial experts,” as defined by the Securities and Exchange Commission. The Committee selects, evaluates and oversees the Company’s independent auditors, approves any engagement of the independent auditors to perform non-audit services, and oversees the Company’s internal accounting and financial controls. It reviews the audited financial statements and discusses them, as well as the adequacy and quality of the Company’s financial reporting principles and procedures, with management and the auditors together and in separate executive sessions. It also reviews and approves related person transactions. The Audit Committee met six times during the fiscal year ended September 30, 2015. The Committee’s report appears on page 22 below.

#### Compensation Committee

The Compensation Committee is composed of five directors. Generally all compensation and fringe benefit programs of the Company are subject to review and recommendation by the Committee, which also reviews and recommends the base salary and incentive compensation of the executive officers and a group of senior managers, as well as grants of equity compensation to all employees. The Chief Executive Officer provides a detailed performance assessment and compensation recommendation for each executive officer (other than himself), which the Committee considers in making its decisions. The Compensation Committee usually considers annual equity grants for executives in its December meeting each year. Other compensation decisions are made throughout the year as circumstances warrant. All compensation actions taken by the Committee are reported to the full Board of Directors, and are subject to the approval of the Board, excluding management directors. The Committee did not use the services of any compensation consultants during the past fiscal year.

The Committee also reviews and makes recommendations to the Board on director compensation and equity awards, on policies and programs for the development of management personnel, as well as management structure and organization. The Compensation Committee met six times during the fiscal year ended September 30, 2015.

The Committee is authorized to delegate to one or more executive officers of the Company the power to make awards under the 1996 Equity Incentive Plan (the “Plan”) to participants who are not subject to Section 16 of the Securities Exchange Act of 1934 and all determinations under the Plan with respect thereto, provided that the Committee establishes the aggregate and individual maximum amounts of such awards, and such other features of the awards as required by applicable law. The Committee has not delegated such authority to date.

#### Nominating and Governance Committee

The Nominating and Governance Committee is composed of four directors. It considers nominations to the Board, develops and implements the Company’s corporate governance principles and practices, and recommends to the Board of Directors’ action related to Board composition, size and effectiveness and management succession plans for the positions of Chairman of the Board and Chief Executive Officer. The Nominating and Governance Committee met six times during the fiscal year ended September 30, 2015.

#### Director Nominations

In identifying potential candidates and selecting nominees for directors, the Nominating and Governance Committee does not foreclose any sources. The Committee reviews candidates recommended by stockholders in the same manner and using the same general criteria as candidates recruited by the Committee or recommended by the Board.

The Nominating and Governance Committee does not rely on a fixed set of qualifications for director nominees. The Committee’s primary objective for director nominees is to create a Board with a broad range of skills and attributes



that is aligned with the Company's strategic needs.

The minimum qualifications for director nominees are that they:

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be able to dedicate time and resources sufficient for the diligent performance of the duties required of a member of the Board,

do not hold positions or interests that conflict with their responsibilities to the Company, and

comply with any other minimum qualifications for either individual directors or the Board as a whole mandated by applicable laws or regulations.

Additionally, at least a majority of members of the Board of Directors must qualify as independent directors in accordance with NASDAQ Capital Market independence rules.

The Nominating and Governance Committee's process for evaluating nominees for director, including nominees recommended by stockholders, is to consider their skills, character and professional ethics, judgment, leadership experience, business experience and acumen, familiarity with relevant industry issues, national and international experience, and other relevant criteria as they may contribute to the Company's success. This evaluation is performed in light of the Committee's views as to what skill set and other characteristics would most complement those of the current directors, including the diversity (principally, of education and backgrounds), age, skills and experience of the Board as a whole.

In order to recommend a candidate for consideration by the Nominating and Governance Committee, a stockholder must provide the Committee with the candidate's name, background and relationship with the proposing stockholder, a brief statement outlining the reasons the candidate would be an effective director of the Company and information relevant to the considerations described above. Such information should be sent to the Nominating and Governance Committee of Sevcon, Inc., 155 Northboro Road, Southborough, Massachusetts 01772, Attention: Corporate Secretary. The Committee may seek further information from or about the candidate, or the stockholder making the recommendation, including information about all business and other relationships between the candidate and the stockholder.

#### Board's Role in Risk Oversight

The Company's business involves many operational and financial risks, which management and the Board seek to mitigate through careful planning and execution. Assessing and managing risk is primarily the responsibility of the Company's management. However, the Board of Directors has an active role, as a whole and also at the committee level, in overseeing management of the Company's risks. The Board of Directors provides oversight by receiving reports from management in Board meetings and conference calls, as well as through periodic management reports. These include reports on the market environment and strategic situation, customer sales results and forecasts, availability of raw materials and components, product development, liquidity, and overall financial performance and forecasts. Board members have the opportunity to provide input and direction to management on managing risks on a current basis, either directly or through the Chairman. In order to ensure that longer term risks are also considered in a timely and consistent manner, each year the full Board reviews and approves a strategic business plan that is used by management throughout the year. The Executive Committee oversees the Company's business activities, including its management of operational risks, between meetings of the Board. The Audit Committee has responsibility for overseeing the Company's internal financial and accounting controls. As such, the Audit Committee regularly discusses with management and the Company's independent registered public accounting firm the Company's major financial and controls-related risk exposures and the steps that management has taken to monitor and control such exposures. The Compensation Committee is responsible for overseeing the management of risks relating to the Company's executive compensation plans and arrangements. The Company believes that Board leadership by an independent Chairman enhances the Board's ability to oversee the Company's operational and financial risks.

#### Director Compensation

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Non-employee directors are each paid a retainer of \$60,000, 50% in cash and 50% in the form of restricted stock, as described below. The Chairman of the Board of Directors receives an additional \$20,000 per year, and the Chairmen of the principal committees receive the following additional amounts for their duties as such: Audit, \$10,000, Compensation, \$5,000, Nominating and Governance, \$5,000. Members of the Audit Committee each receive an additional \$2,000 for their duties as such, and the members of the Compensation and Nominating and Governance Committees each receive \$1,500. The members of ad hoc committees appointed to address specific matters also receive additional compensation, depending on the circumstances.

Half of the non-employee directors' annual retainer is in the form of an equity grant to align their interests with those of the stockholders. In 2015, such grants were for 3,400 shares of restricted stock, determined by dividing \$30,000 by the average share price for calendar year 2014 and rounding to the nearest 100 shares. Such restricted shares will fully vest the day before the 2016 annual meeting of stockholders or, if earlier, upon the recipient's death or disability or upon a change in control of the Company. Restricted shares may not be sold, assigned, transferred, pledged or otherwise disposed of by the recipient until they vest. If the recipient's service as a director of the Company is terminated for any reason other than the recipient's death or disability, any unvested shares will be forfeited and returned to the Company, unless the Compensation Committee determines otherwise in its discretion.

The following table shows compensation paid to all non-employee directors during fiscal 2015:

Name	Fees Earned or Paid in Cash (\$)	Stock Awards \$(1)(2)	Total (\$)
Glen Angiolillo	34,842	24,956	59,798
Maarten D. Hemsley	35,781	24,956	60,737
William J. Ketelhut	56,421	24,956	81,377
Ryan J. Morris	29,265	24,956	54,221
Paul B. Rosenberg(3)(4)	9,951	-	9,951
Walter M. Schenker	36,562	24,956	61,518
Marvin G. Schorr	30,593	24,956	55,549
Bernard F. Start(4)	8,236	-	8,236
David R.A. Steadman	33,593	24,956	58,549
Paul O. Stump	30,921	24,956	55,877
Fred A. Wang	33,749	24,956	58,705

(1) Represents the aggregate grant date fair value of the restricted stock awards received by the director during fiscal 2015, determined in accordance with FASB ASC Topic 718.

(2) As of September 30, 2015, each non-employee director held 3,400 shares of restricted stock.

(3) Mr. Rosenberg was a participant in the Company's Directors Retirement Plan, which was terminated in 1997. The change in value of his accumulated benefit under the Plan in 2015 was \$1,656.

(4) Messrs. Rosenberg and Start served until the 2015 annual meeting.

#### Stock Ownership Policy

In 2004, the Board adopted Equity Compensation Guidelines in which it established a target level of stock ownership for directors of twice the level of annual cash compensation. Grants of restricted stock will be intended in part to assist in reaching these levels of ownership over time. Shares held by members of a person's immediate family or a trust for his or their sole benefit may be counted towards the ownership requirement. Each director is required to refrain from selling Company stock acquired as restricted stock (other than to make required tax payments related to a grant) if the value, based on current market price, of his Company stock after the sale would be below his designated ownership level. The Compensation Committee has discretion to make exceptions in extraordinary circumstances where not contrary to Company goals, such as cases of significant personal hardship.



## AUDIT COMMITTEE REPORT

In the course of its oversight of the Company's financial reporting process, the Audit Committee of the Board of Directors has (i) reviewed and discussed with management the Company's audited financial statements for the fiscal year ended September 30, 2015, (ii) discussed with RSM US LLP, the Company's independent auditors, the matters required to be discussed by Statement on Auditing Standard No. 16, Communications with Audit Committees, and (iii) received the written disclosures and the letter from RSM US LLP required by applicable requirements of the Public Company Accounting Oversight Board regarding RSM US LLPs communications with the Audit Committee concerning independence, and discussed with RSM US LLP its independence.

Based on the foregoing review and discussions, the Committee recommended to the Board of Directors that the audited financial statements for the year ended September 30, 2015 be included in the Company's Annual Report on Form 10-K for filing with the Securities and Exchange Commission.

## Members of the Audit Committee

Glen J. Angiolillo, Chairman  
 Maarten D. Hemsley  
 William J. Ketelhut  
 David R. A. Steadman  
 Paul O. Stump

## EXECUTIVE COMPENSATION

## Compensation Tables

The following tables provide information for the last fiscal year concerning the compensation of each of the executive officers of the Company whose total compensation exceeded \$100,000 in the most recent fiscal year.

## Fiscal 2015 Summary Compensation Table

Name and Principal Position	Year	Salary (\$)(1)	Bonus (\$)(1)	All Other Compensation (\$)(1)	Total (\$)
Mathew Boyle, President and Chief Executive Officer	2015	\$327,183	\$-	\$ 2,349	\$329,532
Paul N. Farquhar, Vice President and Chief Financial Officer	2014	\$338,550	\$50,482	\$ 2,424	\$391,456
	2015	\$200,874	\$-	\$ 1,597	\$202,471
	2014	\$207,852	\$30,995	\$ 1,648	\$240,495

Messrs. Boyle and Farquhar are residents of the United Kingdom and receive their cash compensation in British Pounds. The amounts shown in the table were determined using the exchange rates (ranging from \$ 1.482 to \$ 1.602 per British Pound during fiscal 2015) in force on the respective payment dates. The following table sets out their cash compensation as actually paid in British Pounds (£):

Name	Year	Salary (£)	Bonus (£)	All Other Compensation (£)
Mr. Boyle	2015	£212,667	£-	£ 1,585
	2014	£ 204,075	£ 31,125	£ 1,459
Mr. Farquhar	2015	£130,567	£-	£ 1,078
	2014	£ 125,291	£ 19,110	£ 992



The Company is party to a Services Agreement with each of Messrs. Boyle and Farquhar that sets forth the principal terms of his employment arrangement with the Company, as described below under “Executive Employment Agreements.”

Outstanding Equity Awards at Fiscal 2015 Year-End

Name	Stock Awards	
	Number of Shares that Have Not Vested (#)	Market Value of Shares That Have Not Vested (\$)(†)
Matthew Boyle	12,000 (1)	\$ 112,920
Matthew Boyle	12,000 (2)	\$ 112,920
Paul N. Farquhar	6,000 (3)	\$ 56,460
Paul N. Farquhar	8,000 (4)	\$ 75,280
Paul N. Farquhar	8,000 (5)	\$ 75,280

(†) Based on the closing sale price, \$9.41, of the Common Stock on September 30, 2015, the last trading day of the fiscal year.

These shares of restricted stock vest as to 6,000 shares on each of (i) the third business day after the Company (1) publicly announces its financial results for fiscal 2015 and (ii) the earlier of December 4, 2016, or the third business day after the Company publicly announces its results for fiscal 2016.

These shares of restricted stock vest as to 6,000 shares on each of (i) the third business day after the Company (2) publicly announces its financial results for fiscal 2015 and (ii) the earlier of December 16, 2016, or the third business day after the Company publicly announces its results for fiscal 2016.

These shares of restricted stock vest as to 3,000 shares on each of (i) the third business day after the Company (3) publicly announces its financial results for fiscal 2015 and (ii) the earlier of December 4, 2016, or the third business day after the Company publicly announces its results for fiscal 2016.

These shares of restricted stock vest as to 2,000 shares on each of (i) the third business day after the Company (4) publicly announces its financial results from fiscal 2015, 2016, 2017 and (ii) the earlier of December 9, 2018 or the third business day after the Company publicly announces its results for fiscal 2018.

These shares of restricted stock vest as to 4,000 shares on each of (i) the third business day after the Company (5) publicly announces its financial results for fiscal 2015 and (ii) the earlier of December 16, 2016, or the third business day after the Company publicly announces its results for fiscal 2016.

Pension Benefits

The U.K. Retirement Plan was frozen effective September 30, 2012 and in consequence there will be no future accrual earned by U.K. executive officers or employees under this defined benefit arrangement. Prior to the freezing of the plan, the executive officers participated in this defined benefit plan, which was based on 1/60th of final U.K. base salary (as defined in the Plan) for each year of service, subject to a maximum of 2/3rds of final U.K. base salary. With



effect from September 30, 2012, the accrued benefits earned by the executive officers, based on their service to this date, will be frozen other than for CPI-based increases to the accrued benefits, which will be applied annually until the executive reaches retirement age.

With effect from October 1, 2012, the executive officers have participated in the Company's U.K. Group Personal Pension Plan ("GPPP"), a defined contribution pension arrangement, with Scottish Widows plc, a U.K. based life, pensions and investment company, which is a subsidiary of Lloyds Banking Group. The Company contributes a minimum of 4% up to a maximum of 8% of the employee's base salary on a matched basis dependent on the employee's personal contribution as a percentage of base salary. A lump sum death in service benefit of eight times the base salary of the executive is payable on the death of the employee during employment.

## Executive Employment Agreements

We have a Services Agreement with each of Messrs. Boyle and Farquhar that sets forth the principal terms of his employment arrangement with the Company. Each officer is entitled to receive a minimum base salary (Mr. Boyle – £212,667 and Mr. Farquhar – £130,567, or \$321,425 and \$197,339, respectively, at the exchange rate in effect on September 30, 2015), which is subject to increase by the Compensation Committee in its discretion. In addition, each officer is eligible to receive an annual cash incentive bonus as determined by the Compensation Committee in its discretion. Each officer is entitled to participate in the Company's pension plan and to receive family health and life insurance benefits on the terms of the respective plans.

Mr. Boyle's agreement continues until terminated by the Company upon at least 12 months' notice, or by Mr. Boyle upon at least three months' notice. Mr. Farquhar's agreement continues until terminated by the Company upon at least six months' notice, or by Mr. Farquhar upon at least three months' notice. For the first 12 months after a change of control, the notice period for termination by the Company is increased to 18 months for Mr. Boyle and 12 months for Mr. Farquhar. Alternatively, the Company may in its discretion make a payment of salary in lieu of the whole or any part of any unexpired notice period, together with a sum equivalent to the fair value of any other benefits of employment provided under the terms of the Agreement. If we terminate the employment of either officer for cause, the officer would not be entitled to notice or compensation.

In addition, we have a Non-Competition and Non-Solicitation Agreement with each of Messrs. Boyle and Farquhar. These and the Service Agreements prohibit Mr. Boyle, for up to 24 months after his termination, and Mr. Farquhar, for up to 12 months after his termination, from (i) competing with, soliciting or enticing customers and employees away from, or disparaging the Company or any of its subsidiaries, and (ii) interfering with the continuance of supplies and services from the Company's principal suppliers.

Upon a change in control of the Company (whether or not the officer's employment is terminated), these agreements provide that vesting of shares of restricted stock and unvested stock options held by such officer would accelerate. (For this purpose, a "change in control" means a change in control of the Company that would be required by SEC rules to be reported in the Company's proxy statement, including the acquisition by any person of beneficial ownership of securities of the Company representing a majority of the combined voting power of the Company's then outstanding securities.) Similarly, if we terminate an officer's employment other than for cause or disability, vesting of shares of restricted stock and unvested stock options held by such officer would accelerate. Upon a change in control of the Company, the Company also must ensure that the officer continues to be provided with a pension plan offering benefits equivalent to the benefits provided under the Company's pension plan in effect on July 1, 2010. The following table sets forth the compensation that would have been due to Messrs. Boyle and Farquhar as a result of a change in control of the Company, and termination of employment where applicable, occurring on September 30, 2015:

## Golden Parachute Compensation

Name	Cash\$(1)	Equity\$(2)	Total
Matthew Boyle	\$ 484,479	\$ 225,800	\$ 710,279
Paul N. Farquhar	\$ 198,296	\$ 207,020	\$ 405,316

(1) Represents the aggregate cash payment that would be due in lieu of notice if the executive's employment was terminated within 12 months after the change in control. Any such payment would be made in British Pounds. The amounts shown in the table were determined using the executives' salary at September 30, 2015 and the exchange rate (1.5114 per Pound) in force on that date.

(2) Represents the aggregate value of restricted stock awards for which vesting would be accelerated, based on the \$9.41 closing sale price of the Company's Common Stock on September 30, 2015. The actual amount received by the officer on the sale of previously restricted stock will depend on market value at the time of

such transactions. A change in control of the Company will trigger accelerated vesting of the officer's outstanding equity awards, regardless of whether the officer's employment is terminated in connection with the change in control transaction.

In the event of a change in control, it is possible that the compensation arrangements for Messrs. Boyle and Farquhar may be renegotiated by the officers, the Board of Directors and/or the Company's merger or acquisition partner, in which case the amounts payable might differ from those shown above.

## TRANSACTIONS WITH RELATED PERSONS

During fiscal 2015 and 2014, no related person transactions requiring disclosure in the proxy statement were identified or submitted to the Audit Committee for approval.

## DEADLINE FOR STOCKHOLDER PROPOSALS FOR 2016 ANNUAL MEETING; ADVANCE NOTICE PROVISIONS FOR STOCKHOLDER PROPOSALS AND NOMINATIONS

The 2017 Annual Meeting of Stockholders will be held on February 7, 2017. In order for a stockholder proposal to be considered for inclusion in the Company's proxy materials for the annual meeting in 2017, it must be received by the Company at 155 Northboro Road, Southborough, Massachusetts 01772, Attention: Treasurer, no later than September 7, 2016.

The by-laws of the Company provide that in order for a stockholder to bring business before or propose director nominations at an annual meeting, the stockholder must give written notice to the Secretary or other specified officer of the Company not less than 50 days nor more than 75 days prior to the meeting, except that if notice thereof is mailed to stockholders or publicly disclosed less than 65 days in advance, the notice given by the stockholder must be received not later than the 15th day following the day on which the notice of such annual meeting date was mailed or public disclosure made, whichever occurs first. The notice must contain specified information about the proposed business or each nominee and the stockholder making the proposal or nomination.

## SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's directors, executive officers and persons owning more than 10% of the Company's registered equity securities to file with the Securities and Exchange Commission reports of their initial ownership and of changes in their ownership of the Company's equity securities and to provide the Company with copies of all Section 16(a) reports they file.

Based on a review of the reports filed by such persons with respect to the Company's last fiscal year, the Company believes that all its executive officers and directors have complied with the Section 16(a) filing requirements except that Mr. Boyle filed one late report regarding the Company's redemption of shares to cover tax withholding upon vesting of restricted stock and Mr. Farquhar filed two late reports regarding such redemptions.

## OTHER BUSINESS

The Board of Directors does not know of any business that will come before the meeting except the matters described in the notice. If other business is properly presented for consideration at the meeting, the enclosed proxy authorizes the persons named therein to vote the shares in their discretion.

APPENDIX A

VOTE BY INTERNET – [www.proxyvote.com](http://www.proxyvote.com)

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form

SEVCON, INC.  
155 NORTHBORO  
ROAD  
SOUTHBOROUGH,  
MA 01772

ELECTRONIC DELIVERY OF FUTURE PROXY MATERIALS

If you would like to reduce the costs incurred by your company in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years.

VOTE BY PHONE – 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:  
KEEP THIS PORTION FOR YOUR RECORDS  
DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

SEVCON, INC.  
The Board of  
Directors  
recommends you  
vote FOR Mr.  
Schenker and  
Dr. Schorr and  
FOR  
proposals 2, 3,  
and 4

1. Election  
of  
Directors  
Nominees:  
To  
be  
elected  
for  
terms  
expiring  
in

2017:

VOTE  
FOR  
TWO

Walter  
M.  
Schenker  
Marvin  
G.  
Schorr  
Alexander  
J.  
Garden  
Matthew  
Goldfarb

For Against Abstain

2. Approve the increase in the number of shares issuable under the Company's 1996 Equity Incentive Plan.

3. Ratify the appointment of the independent registered public accounting firm for fiscal 2016.

4. Approve the fiscal 2015 compensation of the Company's executive officers.

Such other business as may properly come before the meeting or any adjournment thereof.

NOTE: Please sign as name appears hereon. Joint owners should each sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such.

Signature [PLEASE SIGN WITHIN BOX] Date Signature (Joint Owners) Date

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Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting:  
The Notice and Proxy Statement and Annual Report are available at [www.proxyvote.com](http://www.proxyvote.com).

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PROXY

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS  
OF SEVCON, INC.

The undersigned hereby appoints Frederick A. Wang, Paul N. Farquhar and Matthew C. Dallett, and each of them with power to act without other and with power of substitution, as proxies and attorneys-in-fact and hereby authorizes them to represent and vote, as provided on the other side, all the shares of Common Stock of Sevcon, Inc. which the undersigned is entitled to vote and, in their discretion, to vote upon such other business as may properly come before the Annual Meeting of Stockholders of the Company to be held February 2, 2016 or any adjournment thereof, with all powers which the undersigned would possess if present at the Meeting.

THIS PROXY CARD, WHEN PROPERLY EXECUTED, WILL BE VOTED IN THE MANNER DIRECTED  
HEREIN BY THE UNDERSIGNED. IF NO DIRECTION IS MADE BUT THE CARD IS SIGNED, THIS PROXY  
CARD WILL BE VOTED FOR THE ELECTION OF MR. SCHENKER AND DR. SCHORR UNDER PROPOSAL  
1, FOR PROPOSAL 2, 3 AND 4 AND IN THE DISCRETION OF THE PROXIES WITH RESPECT TO SUCH  
OTHER BUSINESS AS MAY PROPERLY COME BEFORE THE MEETING.

(Continued and to be marked, dated and signed, on the other side)