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SERVOTRONICS INC /DE/  
Form 10QSB  
November 14, 2005

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended September 30, 2005

\_ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

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

Commission File No. 1 - 07109

SERVOTRONICS, INC.

-----  
(Exact name of small business issuer as specified in its charter)

Delaware

16-0837866

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(IRS Employer  
Identification No.)

1110 Maple Street, Elma, New York 14059-0300

-----  
(Address of principal executive offices)

716-655-5990

-----  
(Issuer's telephone number, including area code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 .

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes \_\_\_\_\_ ; No \_\_\_\_\_ X

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

Class	Outstanding at October 31, 2005
Common Stock, \$.20 par value	2,492,901

Transitional Small Business Disclosure Format (Check one):

Yes \_\_\_\_\_ ; No \_\_\_\_\_ X

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PART I. FINANCIAL INFORMATION

- Item 1. Financial Statements (Unaudited)
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  - b) Consolidated statement of operations for the three and nine months ended September 30, 2005 and 2004
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SERVOTRONICS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEET  
(\$000's omitted except per share data)  
(Unaudited)

	September 30, 2005
	-----
Assets	
Current assets:	
Cash	\$ 3,787
Accounts receivable, net	3,463
Inventories, net	6,153
Prepaid income taxes	18
Deferred income taxes	471
Other assets	1,219
	-----
Total current assets	15,111
	-----

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Property, plant and equipment, net	6,311
Other non-current assets	570
	-----
	\$ 21,992
	=====
Liabilities and Shareholders' Equity	
Current liabilities:	
Current portion of long-term debt	\$ 381
Accounts payable	612
Accrued employee compensation and benefit costs	871
Other accrued liabilities	448
Accrued income taxes	98
	-----
Total current liabilities	2,410
	-----
Long-term debt	5,241
Deferred income taxes	434
Other non-current liability	304
Shareholders' equity:	
Common stock, par value \$.20; authorized 4,000,000 shares; issued 2,614,506 shares	523
Capital in excess of par value	13,033
Retained earnings	2,827
Accumulated other comprehensive loss	(125)
	-----
	16,258
Employee stock ownership trust commitment	(2,135)
Treasury stock, at cost 121,605 shares	(520)
	-----
Total shareholders' equity	13,603
	-----
	\$ 21,992
	=====

See notes to consolidated financial statements

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SERVOTRONICS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF OPERATIONS  
(\$000's omitted except per share data)  
(Unaudited)

Three Months Ended		Nine
September 30,		Se
2005	2004	2005
----	----	----

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Net revenues	\$ 5,826	\$ 5,383	\$ 17,645
Costs and expenses:			
Cost of goods sold, exclusive of depreciation	4,083	4,031	12,950
Selling, general and administrative	1,113	913	3,109
Interest	67	36	163
Depreciation and amortization	164	159	501
	-----	-----	-----
	5,427	5,139	16,723
	-----	-----	-----
Income before income taxes	399	244	922
Income tax provision	147	90	341
	-----	-----	-----
Net income	\$ 252	\$ 154	\$ 581
	=====	=====	=====
Income Per Share:			
Basic			
-----			
Net income per share	\$ 0.12	\$ 0.08	\$ 0.28
	=====	=====	=====
Diluted			
-----			
Net income per share	\$ 0.12	\$ 0.07	\$ 0.27
	=====	=====	=====

See notes to consolidated financial statements

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SERVOTRONICS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(\$000's omitted)  
(Unaudited)

	Nine Mo Septe 2005
	-----
Cash flows related to operating activities:	
Net income	\$ 581
Adjustments to reconcile net income to net cash provided by operating activities -	
Depreciation and amortization	501
Change in assets and liabilities -	
Accounts receivable	(129)
Inventories	688
Prepaid income taxes	(18)
Other assets	325
Other non-current assets	(34)
Accounts payable	(183)
Accrued employee compensation and benefit costs	66
Accrued income taxes	31
Other accrued liabilities	296

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Net cash provided by operating activities	2,124
Cash flows related to investing activities:	
Capital expenditures - property, plant and equipment	(284)
Net cash used in investing activities	(284)
Cash flows related to financing activities:	
Principal payments on long-term debt	(159)
Net cash used in financing activities	(159)
Net increase in cash	1,681
Cash at beginning of period	2,106
Cash at end of period	\$ 3,787

See notes to consolidated financial statements  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(\$000 omitted in tables except for per share data)

1. Basis of presentation

The consolidated financial statements include the accounts of Servotronics, Inc. (the "Company") and its majority owned subsidiaries.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-QSB and Item 310 of Regulation S-B. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

The accompanying consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. All such adjustments are of a normal recurring nature. Operating results for the nine months ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ended December 31, 2005. The consolidated financial statements should be read in conjunction with the annual report and the notes thereto.

2. Summary of risk factors and significant accounting policies

Risk factors

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The aviation and aerospace industries as well as markets for the Company's consumer products are facing new and evolving challenges on a global basis. The success of the Company depends upon the trends of the economy, including interest rates, income tax laws, governmental regulation, legislation, and other risk factors. In addition, uncertainties in today's global economy, global competition, the effect of terrorism, difficulty in predicting defense and other government appropriations, the vitality of the commercial aviation industry and its ability to purchase new aircraft, the willingness and ability of the Company's customers to fund long-term purchase programs, volatile market demand and the continued market acceptance of the Company's advanced technology and cutlery products make it difficult to predict the impact on future financial results.

Revenue recognition  
-----

The Company's revenues are recognized when the risks and rewards of ownership and title to the product are transferred to the customer as units are shipped and as terms and conditions of purchase orders are met.

3. Inventories  
-----

	September 30, 2005
	-----
Raw materials and common parts	\$ 3,213
Work-in-process	2,400
Finished goods	788
	-----
	6,401
Less common parts expected to be used after one year	(248)
	-----
	\$ 6,153
	=====

Inventories are stated at the lower of standard cost or net realizable value. Cost includes all cost incurred to bring each product to its present location and condition, which approximates actual cost (first-in, first-out). Market provisions in respect of net realizable value and obsolescence are applied to the gross value of the inventory. Pre-production and start-up costs are expensed as incurred.

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4. Property, plant and equipment  
-----

	September 30, 2005
	-----
Land	\$ 25
Buildings	6,487
Machinery, equipment and tooling	10,630
	-----
	17,142
Less accumulated depreciation	(10,831)
	-----

Property, plant and equipment includes land and building under a \$5,000,000 capital lease which can be purchased for a nominal amount at the end of the lease term. As of September 30, 2005, accumulated amortization on the building amounted to approximately \$1,450,000. The associated current and long-term liabilities are discussed in footnote 5 to the consolidated financial statements. The Company believes that it maintains property and casualty insurance in amounts adequate for the risk and nature of its assets and operations and which are generally customary in its industry.

5. Long-term debt  
 -----

Industrial Development Revenue Bonds; secured by a letter of credit from a bank with interest payable monthly at a floating rate (2.95% at September 30, 2005)

Term loan payable to a financial institution interest at LIBOR plus 2% (5.50% at September 30, 2005); quarterly principal payments of \$17,500 commencing January 1, 2005; payable in full in the fourth quarter of 2009

Term loan payable to a financial institution interest at LIBOR plus 2% (5.39% at September 30, 2005) quarterly principal payments of \$26,786 through the fourth quarter of 2011

Secured term loan payable to a government agency, monthly payments of approximately \$1,455 with interest waived payable through second quarter of 2012

Secured term loan payable to a government agency monthly payments of \$1,950 including interest fixed at 3% payable through fourth quarter of 2015

Less current portion

Industrial Development Revenue Bonds were issued by a government agency to finance the construction of the Company's headquarters/Advanced Technology facility. Annual sinking fund payments of \$170,000 commenced December 1, 2000 and continue through 2013, with a final payment of \$2,620,000 due December 1, 2014. The Company has agreed to reimburse the issuer of the letter of credit if there are draws on that letter of credit. The Company pays the letter of credit bank an annual fee of 1% of the amount secured thereby and pays the remarketing agent for the bonds an annual fee of .25% of the principal amount outstanding. The Company's interest under the facility capital lease has been pledged to secure its obligations to the government agency, the bank and the bondholders.

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The Company also has a \$1,000,000 line of credit on which there was no balance outstanding at September 30, 2005.

6. Common shareholders' equity

	Common stock		Capital in excess of par value	Retained earnings	ESOP	Treasury stock	Comprehensive income
	Number of shares issued	Amount					
Balance December 31, 2004	2,614,506	\$523	\$13,033	\$2,246	(\$ 2,135)	(\$ 520)	
Comprehensive income							
Net income	-	-	-	\$ 581	-	-	\$ 581
Comprehensive income	-	-	-	-	-	-	\$ 581
Balance September 30, 2005	2,614,506	\$523	\$13,033	\$2,827	(\$ 2,135)	(\$ 520)	

Earnings per share

Basic earnings per share are computed by dividing net earnings by the weighted average number of shares outstanding during the period. Diluted earnings per share are computed by dividing net earnings by the weighted average number of shares outstanding during the period plus the number of shares of common stock that would be issued assuming all contingently issuable shares having a dilutive effect on earnings per share were outstanding for the period.

	Three Months Ended		Nine Months Ended
	September 30,		
	2005	2004	2005
Net income	\$ 251	154	\$ 580
Weighted average common shares outstanding (basic)	2,071	2,048	2,071
Incremental shares from assumed conversions of stock options	66	66	69
Weighted average common shares outstanding (diluted)	2,137	2,114	2,140
Basic			
Net income per share	\$ 0.12	\$ 0.08	\$ 0.28
Diluted			



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Net income per share \$ 0.12 \$ 0.07 \$ 0.27  
===== ===== =====

7. Business segments  
 -----

The Company operates in two business segments, Advanced Technology Group (ATG) and Consumer Products Group (CPG). The Company's reportable segments are strategic business units that offer different products and services. The segments are composed of separate corporations and are managed separately. Operations in ATG involve the design, manufacture, and marketing of servo-control components (i.e., control valves, actuators, etc.) for government, commercial and industrial applications. CPG's operations involve the design, manufacture and marketing of a variety of cutlery products for use by consumers and government agencies. The Company derives its primary sales revenue from domestic customers, although a significant portion of finished products are for foreign end use.

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	Advanced Technology Group -----		Consumer Products Group -----		
	Nine months ended September 30,		Nine months ended September 30,		
	2005	2004	2005	2004	
	----	----	----	----	
Revenues from unaffiliated customers	\$ 10,112	\$ 8,352	\$ 7,533	\$ 7,999	\$
	=====	=====	=====	=====	=
Profit	\$ 1,869	\$ 1,247	\$ 269	\$ 583	\$
	=====	=====	=====	=====	=
Depreciation and amortization					
Interest expense					
General corporate expense					
Income before income taxes					\$
					=

	Advanced Technology Group -----		Consumer Products Group -----		
	Three months ended September 30,		Three months ended September 30,		
	2005	2004	2005	2004	
	----	----	----	----	
Revenues from unaffiliated customers	\$ 3,748	\$ 3,023	\$ 2,078	\$ 2,360	\$
	=====	=====	=====	=====	=
Profit	\$ 895	\$ 465	\$ (81)	\$ 107	\$
	=====	=====	=====	=====	=
Depreciation and amortization					

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Interest expense

General corporate expense

Income before income taxes

\$  
===

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following table sets forth for the period indicated the percentage relationship of certain items in the consolidated statement of operations to net revenues, and the percentage increase or decrease of such items as compared to the indicated prior period.

	Relationship to net revenues three months ended		Period to period \$ increase (decrease)	Relationship to net revenues nine months ended
	September 30, 2005	September 30, 2004	05-04	September 2005
Net revenues				
Advanced Technology Group	64.3%	56.2%	24.0%	57.3%
Consumer Products Group	35.7%	43.8%	(12.0%)	42.7%
	-----	-----		-----
	100.0%	100.0%	8.2%	100.0%
Cost of goods sold, exclusive of depreciation	70.8%	74.9%	2.3%	73.6%
	-----	-----		-----
Gross profit	29.2%	25.1%	25.9%	26.4%
	-----	-----		-----
Selling, general and administrative	18.4%	17.0%	17.4%	17.4%
Interest	1.2%	0.7%	86.1%	0.9%
Depreciation and amortization	2.8%	3.0%	3.1%	2.8%
	-----	-----		-----
	22.4%	20.7%	17.6%	21.1%
	-----	-----		-----
Income before income taxes	6.8%	4.4%	63.4%	5.3%
Income tax provision	2.5%	1.5%	63.3%	2.0%
	-----	-----		-----
Net income	4.3%	2.9%	63.4%	3.3%
	=====	=====		=====

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Management Discussion

During the nine month period ended September 30, 2005 and for the comparable period ended September 30, 2004, approximately 43% of the Company's revenues were derived from contracts with agencies of the U.S. Government or their prime contractors and their subcontractors. Total government sales are anticipated to decrease in 2005 as a result of the scheduled completion of a significant government order to the CPG as previously reported. The Company's business is performed under fixed price contracts. Allocations of defense expenditures and government involvement in overseas military operations have had an impact on the Company's financial results. While the Company remains optimistic in relation to these opportunities, it recognizes that sales to the

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government are affected by defense budgets, the foreign policies of the U.S. and other nations, the level of military operations and other factors and, as such, it is difficult to predict the impact on future financial results. The Company's commercial business is affected by such factors as uncertainties in today's global economy, global competition, the vitality and ability of the commercial aviation industry to purchase new aircraft, market demand and acceptance both for the Company's products and its customers' products which incorporate Company-made components.

### Results of Operations

-----

The Company's consolidated results of operations for the nine month period ended September 30, 2005 showed an approximate 7.9% increase in net revenues to \$17,645,000 with an increase in net income of approximately 10.2% to \$581,000 when compared to the same nine month period of 2004. The Company's consolidated results of operations for the three month period ended September 30, 2005 showed an approximate 8.2% increase in net revenues to \$5,826,000 with an increase in net income of approximately 63.4% to \$252,000 when compared to the same three month period in 2004. The increase in revenues is primarily attributed to an increase in government and commercial shipments by the Advanced Technology Group and price increases.

Gross margins for the nine and three month periods ended September 30, 2005 increased as a percentage of sales when compared to the same period in 2004 because of increased sales volume, the aforementioned price increases, mix of products and because the increases in incremental sales resulted in the fixed overhead costs becoming a smaller percentage of total costs. The Company continues to incur costs associated with prototype and preproduction activities that are expensed in the period incurred.

Selling, general and administrative (SG&A) costs increased approximately 13.3% when compared to the same nine month period in 2004 and increased 21.9% for the three month period ended September 30, 2005 when compared to the same three month period in 2004. This increase, which was partially mitigated by \$162,000 in retroactive price increases, is attributable to costs incurred for professional services which are related to corporate governance necessitated by the Sarbanes-Oxley Act, increased legal and accounting services related to the previously reported issues identified in item 3 and a change in the Company's Independent Auditors as well as increased marketing costs supporting the expanded sales effort of the ATG and CPG.

Interest expense increased for the nine months and quarter ended September 30, 2005 when compared to the same period in 2004 primarily due to an increase in institutional debt and market driven interest rates.

The Company continues to take advantage of the tax benefit for extraterritorial sales as well as the new manufacturing deductions allowable under the American Jobs Creation Act of 2004, which is reflected in the effective tax rate of approximately 37%.

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### Liquidity and Capital Resources

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The Company's primary liquidity and capital requirements relate to the Company's working capital needs; primarily inventory, accounts receivable, capital investments in facilities, machinery, tools/dies and equipment and principal/interest payments on indebtedness. The Company's primary sources of liquidity in 2005 have been from positive cash flows from operations. These cash flows have been positively affected by efforts in inventory control and

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satisfactory payment terms with suppliers and customers.

As of September 30, 2005 there are no material commitments for capital expenditures.

The Company also has a \$1,000,000 line of credit on which there was no balance outstanding at September 30, 2005.

### Item 3. CONTROLS AND PROCEDURES

(a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. As of September 30, 2005, the Company carried out an evaluation under the supervision and with the participation of its management, including the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of the Company's disclosure controls and procedures. Based upon that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures are effective in timely alerting them to the material information relating to the Company (or the Company's consolidated subsidiaries) required to be included in the Company's periodic filings with the SEC, such that the information relating to the Company, required to be disclosed in SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company's management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

(b) CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING. Other than as described below, there has been no change in our internal control over financial reporting that occurred during the fiscal quarter ended September 30, 2005 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

We are in the initial phases of establishing compliance under Section 404 of the Sarbanes-Oxley Act which, consistent with current government regulations, will be effective for our Company for the fiscal year ending December 31, 2007. We anticipate expending significant additional resources to evaluate and maintain appropriate controls and procedures and to prepare the required financial and other information during the process of establishing our Section 404 Sarbanes-Oxley controls and procedures.

(c) IDENTIFIED CONTROLS AND PROCEDURE WEAKNESSES FOR PAYROLL DISBURSEMENTS. As previously reported in the Company's amended quarterly report on Form 10-QSB/A for the quarterly period ended June 30, 2005 (the "Amended Second Quarter Report"), the Company's Interim CFO (who is now the current CFO) and the CEO concluded that, as of June 30, 2005, the Company's disclosure controls and procedures were not effective as a result of the Company's discovery of certain unauthorized disbursements by a senior finance officer. The Company reported this discovery to all appropriate parties including the Company's Attorney, the Audit Committee, the Company's Independent Auditors, the SEC, the AMEX and the District Attorney of Erie County, New York. An investigation was immediately initiated and continued through the third quarter ended September 30, 2005. Reference is made to the Amended Second Quarter Report for a more detailed description. Subsequent to September 30, 2005, the Company received a forensic accounting report which essentially supported the original allegations as described in the Amended Second Quarter Report.

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The CEO and CFO believe that the Company has corrected the weaknesses in its internal controls and procedures relative to certain payroll disbursements as described in the Amended Second Quarter Report and are not aware of any other weaknesses in the Company's internal controls and procedures.

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## PART II

### OTHER INFORMATION

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

The annual meeting of shareholders of the Registrant was held on July 1, 2005. At the meeting, each of the four directors of the Registrant was elected to serve until the next annual meeting of shareholders and until his successor is elected and qualified. The following table shows the results of the voting at the meeting.

Name of Nominee	For	Withheld Authority
Dr. Nicholas D. Trbovich	2,312,351	6,514
Nicholas D. Trbovich, Jr.	2,317,444	1,421
Dr. William H. Duerig	2,318,468	397
Donald W. Hedges	2,313,375	5,490

#### Item 6. EXHIBITS

- 31.1 Certification of Chief Financial Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Executive Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

#### FORWARD-LOOKING STATEMENTS

In addition to historical information, certain sections of this Form 10-QSB contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, such as those pertaining to the Company's capital resources and profitability. Forward-looking statements involve numerous risks and uncertainties. The Company derives a material portion of its revenues from contracts with agencies of the U.S. Government or their prime contractors. The Company's business is performed under fixed price contracts and the following factors, among others discussed herein, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements: uncertainties in today's global economy and global competition, and difficulty in predicting defense appropriations, the vitality of the commercial aviation industry and its ability to purchase new aircraft, the willingness and ability of the Company's customers to fund long-term purchase programs, and market demand and acceptance both for the Company's products and its customers' products which incorporate Company-made components. The success of the Company also depends upon the trends

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of the economy, including interest rates, income tax laws, governmental regulation, legislation, population changes and those risk factors discussed elsewhere in this Form 10-QSB. Readers are cautioned not to place undue reliance on forward-looking statements, which reflect management's analysis only as of the date hereof. The Company assumes no obligation to update forward-looking statements.

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SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 11, 2005

SERVOTRONICS, INC.

By: /s/ Dr. Nicholas D. Trbovich, Chief Executive Officer

-----  
Dr. Nicholas D. Trbovich  
Chief Executive Officer

By: /s/ Cari L. Jaroslowsky, Chief Financial Officer

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Cari L. Jaroslowsky  
Chief Financial Officer

By: /s/ Raymond C. Zielinski, Vice President

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Raymond C. Zielinski  
Vice President

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