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SERVOTRONICS INC /DE/

Form 10-Q

November 08, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

or

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

Commission File No. 1-07109

SERVOTRONICS, INC.

(Exact name of registrant as specified in its charter)

Delaware

16-0837866

(State or other jurisdiction of

Employer

(I. R. S.

incorporation or organization)

Identification

No.)

1110 Maple Street

Elma, New York 14059

(Address of principal executive offices) (zip code)

(716) 655-5990

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

Yes  No

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

Class	Outstanding at October 31, 2011	
Common Stock, \$.20 par value		2,237,371

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SERVOTRONICS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(\$000's omitted except share and per share data)

	September 30, 2011 (Unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$4,934	\$4,447
Accounts receivable, net	5,879	5,427
Inventories, net	11,737	11,032
Prepaid income taxes	-	226
Deferred income taxes	567	567
Other assets	469	352
Total current assets	23,586	22,051
Property, plant and equipment, net	6,099	6,159
Other non-current assets	325	296
Total Assets	\$30,010	\$28,506
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	\$235	\$323
Current portion of capital lease related party	81	81
Accounts payable	1,285	1,247
Accrued employee compensation and benefit costs	1,514	1,332
Accrued income taxes	7	-
Other accrued liabilities	341	230
Total current liabilities	3,463	3,213
Long-term debt	3,031	3,058
Long-term portion of capital lease related party	354	414
Deferred income taxes	509	509
Shareholders' equity:		
Common stock, par value \$.20; authorized 4,000,000 shares; issued 2,614,506 shares; outstanding 1,981,877 (1,981,877 – 2010) shares	523	523
Capital in excess of par value	13,647	13,491
Retained earnings	12,652	11,467
Accumulated other comprehensive loss	(78	) (78
Employee stock ownership trust commitment	(1,367	) (1,367
Treasury stock, at cost 377,135 (377,135 – 2010) shares	(2,724	) (2,724
Total shareholders' equity	22,653	21,312
Total Liabilities and Shareholders' Equity	\$30,010	\$28,506

See notes to consolidated financial statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenue	\$8,808	\$7,346	\$25,496	\$23,433
Costs, expenses and other income:				
Cost of goods sold, exclusive of depreciation and amortization	6,284	5,643	18,447	16,839
Selling, general and administrative	1,204	1,225	3,757	3,682
Interest expense	14	16	44	50
Depreciation and amortization	163	159	498	483
Other income, net	(150)	(6)	(164)	(29)
	7,515	7,037	22,582	21,025
Income before income tax provision	1,293	309	2,914	2,408
Income tax provision	389	104	876	802
Net income	\$904	\$205	\$2,038	\$1,606
Income per share:				
Basic				
Net income per share	\$0.46	\$0.1	\$1.03	\$0.82
Diluted				
Net income per share	\$0.44	\$0.1	\$0.97	\$0.75

See notes to consolidated financial statements

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

	Nine Months Ended September 30,	
	2011	2010
Cash flows related to operating activities:		
Net income	\$2,038	\$1,606
Adjustments to reconcile net income to net Cash generated in operating activities:		
Depreciation and amortization	498	483
Change in assets and liabilities:		
Accounts receivable	(452)	(460)
Inventories	(705)	366
Prepaid income taxes	382	339
Other assets	(117)	(55)
Other non-current assets	(29)	(104)
Accounts payable	38	(150)
Accrued employee compensation and benefit costs	179	303
Accrued income taxes	7	-
Other accrued liabilities	111	(443)
Net cash generated in operating activities	1,950	1,885
Cash flows related to investing activities:		
Capital expenditures - property, plant and equipment	(435)	(312)
Proceeds from Certificates of Deposit	-	242
Net cash used in investing activities	(435)	(70)
Cash flows related to financing activities:		
Principal payments on long-term debt	(115)	(113)
Principal payments on capital lease related party	(60)	(59)
Cash dividend	(336)	(336)
Purchase of stock options	(517)	(573)
Net cash used in financing activities	(1,028)	(1,081)
Net increase in cash and cash equivalents	487	734
Cash and cash equivalents at beginning of period	4,447	3,825
Cash and cash equivalents at end of period	\$4,934	\$4,559

See notes to consolidated financial statements



SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by United States generally accepted accounting principles 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 three and nine months ending September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The consolidated financial statements should be read in conjunction with the 2010 annual report and the notes thereto.

2. Business Description and Summary of Significant Accounting Policies

Business Description

Servotronics, Inc. and its subsidiaries design, manufacture and market advanced technology products consisting primarily of control components and consumer products consisting of knives and various types of cutlery and other edged products.

Principles of Consolidation

The consolidated financial statements include the accounts of Servotronics, Inc. and its wholly-owned subsidiaries (the "Company"). All intercompany balances and transactions have been eliminated upon consolidation.

Cash and Cash Equivalents

The Company considers cash and cash equivalents to include all cash accounts and short-term investments purchased with an original maturity of three months or less. Cash equivalents consist primarily of short-term certificates of deposits.

Accounts Receivable

The Company grants credit to substantially all of its customers and carries its accounts receivable at original invoice amount less an allowance for doubtful accounts. On a periodic basis, the Company evaluates its accounts receivable and establishes an allowance for doubtful accounts based on history of past write-offs, collections, and current credit conditions. The allowance for doubtful accounts amounted to approximately \$120,000 at September 30, 2011 and \$117,000 at December 31, 2010.

Revenue Recognition

Revenues are recognized as services are rendered or as units are shipped and at the designated FOB point consistent with the transfer of title, risks and rewards of ownership. Such purchase orders generally include specific terms relative to quantity, item description, specifications, price, customer responsibility for in-process costs, delivery

schedule, shipping point, payment and other standard terms and conditions of purchase.

#### Inventories

Inventories are stated at the lower of standard cost or net realizable value. Cost includes all costs 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 inventory expected to be used in greater than one year are applied to the gross value of the inventory through a reserve of approximately \$703,000 and \$651,000 at September 30, 2011 and December 31, 2010, respectively. Pre-production and start-up costs are expensed as incurred.

The purchase of suppliers' minimum economic quantities of material such as steel, etc. may result in a purchase of quantities exceeding one year of customer requirements. Also, in order to maintain a reasonable and/or agreed to lead time, certain larger quantities of other product support items may have to be purchased and may result in over one year's supply.

SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Shipping and Handling Costs

Shipping and handling costs are classified as a component of cost of goods sold.

Property, Plant and Equipment

Property, plant and equipment is carried at cost; expenditures for new facilities and equipment and expenditures which substantially increase the useful lives of existing plant and equipment are capitalized; expenditures for maintenance and repairs are expensed as incurred. Upon disposal of properties, the related cost and accumulated depreciation are removed from the respective accounts and any profit or loss on disposition is included in income.

Depreciation is provided on the basis of estimated useful lives of depreciable properties, primarily by the straight-line method for financial statement purposes and by accelerated methods for tax purposes. Depreciation expense includes the amortization of capital lease assets. The estimated useful lives of depreciable properties are generally as follows:

Buildings and improvements	5-39 years
Machinery and equipment	5-15 years
Tooling	3-5 years

Income Taxes

The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of operating loss and credit carryforwards and temporary differences between the carrying amounts and the tax basis of assets and liabilities. The Company and its subsidiaries file a consolidated federal income tax return, a consolidated New York State income tax return and separate Pennsylvania, Arkansas and Texas state income tax returns.

The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company did not have any accrued interest or penalties included in its consolidated balance sheets at September 30, 2011 or December 31, 2010, and did not recognize any interest and/or penalties in its consolidated statements of income during the three and nine months ended September 30, 2011 and 2010.

Supplemental cash flow information

Income taxes paid during the three months ended September 30, 2011 and 2010 amounted to approximately \$291,000 and \$62,000, respectively, and amounted to \$517,000 and \$475,000 for the nine months ended September 30, 2011 and 2010, respectively. Interest paid during the three months ended September 30, 2011 and 2010 amounted to approximately \$14,000 and \$16,000, respectively, and amounted to \$44,000 and \$50,000 for the nine months ended September 30, 2011 and 2010, respectively. The Company reduced its tax liability by approximately \$156,000 related to the surrender of unexercised stock options recorded as an increase to capital in excess of par value.

SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Employee Stock Ownership Plan

Contributions to the employee stock ownership plan are determined annually by the Company according to plan formula.

Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable based on undiscounted future operating cash flow analyses. If an impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal. The Company has determined that no impairment of long lived assets existed at September 30, 2011 and December 31, 2010.

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain balances as previously reported were reclassified to conform with classifications adopted in the current period.

Research and Development Costs

Research and development costs are expensed as incurred.

Concentration of Credit Risks

Financial instruments that potentially subject the Company to concentration of credit risks principally consist of cash accounts in financial institutions. Although the accounts exceed the federally insured deposit amount, management does not anticipate nonperformance by the financial institutions. Refer to Note 12, Business Segments, for disclosures related to customer concentrations.

Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses are reasonable estimates of their fair value due to their short maturity. Based on variable interest rates and the borrowing rates currently available to the Company for loans similar to its long-term debt and capital lease, the fair value approximates its carrying amount.

Pending Accounting Pronouncements

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income," (ASU 2011-05) which improves the comparability, consistency, and transparency of financial reporting and increases the prominence of items reported in other comprehensive income. ASU is effective for fiscal years beginning on or after December 15, 2011 and early adoption is permitted. The Company is currently evaluating the impact of adopting the guidance.

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SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Inventories

	September 30, 2011	December 31, 2010
	(\$000's omitted)	
Raw materials and common parts	\$ 5,427	\$ 5,491
Work-in-process	4,250	3,358
Finished goods	2,060	2,183
Total inventories, net of reserve	\$ 11,737	\$ 11,032

4. Property, Plant and Equipment

	September 30, 2011	December 31, 2010
	(\$000's omitted)	
Land	\$ 25	\$ 25
Buildings	7,138	7,060
Machinery, equipment and tooling (including capital lease)	12,799	12,444
	19,962	19,529
Less accumulated depreciation and amortization	(13,863 )	(13,370 )
Total property, plant and equipment	\$ 6,099	\$ 6,159

Property, plant and equipment includes land and building in Elma, New York, 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, 2011 and December 31, 2010, accumulated amortization on the building amounted to approximately \$2,390,000 and \$2,293,000, respectively. Amortization expense amounted to \$32,000 and \$31,000 for the three month periods ended September 30, 2011 and 2010, respectively, and amounted to \$97,000 and \$98,000 for the nine month periods ended September 30, 2011 and 2010, respectively. The associated current and long-term liabilities are discussed in Note 5, Long-Term Debt, of the accompanying consolidated financial statements. Property, plant and equipment also includes machinery and equipment under a \$588,000 capital lease with related party. As of September 30, 2011 and December 31, 2010, accumulated amortization on the machinery and equipment amounted to approximately \$161,000 and \$98,000, respectively. Amortization expense amounted to \$21,000 for the three month periods ended September 30, 2011 and 2010, respectively, and amounted to \$63,000 for the nine month periods ended September 30, 2011 and 2010, respectively. The associated current and long-term liabilities are discussed in Note 6, Capital Lease – Related Party, of the accompanying consolidated financial statements.

Depreciation expense amounted to \$108,000 and \$105,000 for the three month periods ended September 30, 2011 and 2010, respectively, and amounted to \$332,000 and \$316,000 for the nine month periods ended September 30, 2011 and 2010, respectively. The combined depreciation and amortization expense were \$163,000 and \$159,000 for the three month periods ended September 30, 2011 and 2010, respectively, and amounted to \$498,000 and \$483,000 for the nine month periods ended September 30, 2011 and 2010, respectively. 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.



SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 5. Long-Term Debt

	September 30, 2011 (\$000's omitted)	December 31, 2010
Industrial Development Revenue Bonds; secured by an equivalent letter of credit from a bank with interest payable monthly at a floating rate (0.44% at September 30, 2011) (A)	\$ 3,130	\$ 3,130
Term loan payable to a financial institution; interest at LIBOR plus 2%, (2.22% at September 30, 2011); quarterly principal payments of \$26,786 through the fourth quarter of 2011	26	107
Secured term loan payable to a government agency; monthly payments of \$1,950 including interest fixed at 3% payable through fourth quarter of 2015	92	107
Secured term loan payable to a government agency; monthly principal payments of approximately \$2,100 with interest waived payable through second quarter of 2012	18	37
	3,266	3,381
Less current portion	(235 )	(323 )
	\$ 3,031	\$ 3,058

(A) The 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 1/4% 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.

The Company also has an unsecured \$1,000,000 line of credit on which there was no balance outstanding at September 30, 2011 and December 31, 2010.

Certain lenders require the Company to comply with debt covenants as described in the specific loan documents, including a debt service ratio. At September 30, 2011 and December 31, 2010, the Company was in compliance with its debt covenants.

## 6. Capital Lease – Related Party

On November 3, 2009, the Company entered into a capital lease with a related party of the Company for certain equipment to be used in the expansion of the Company's capabilities and product lines. See Note 10, Related Party Transactions, of the accompanying consolidated financial statements for information on the related party transaction. Monthly payments of \$7,500, which include an imputed fixed interest rate of 2.00%, commenced November 3, 2009



and will continue through the fourth quarter of 2016. At September 30, 2011, the present value of the minimum lease payment is approximately \$435,000 (after subtracting approximately \$23,000 of imputed interest).

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SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. Income Taxes

The Company did not have any material uncertain tax positions or unrecognized tax benefits or obligations as of September 30, 2011 and December 31, 2010.

The Company and/or its subsidiaries file income tax returns in the United States federal jurisdiction and in the states of New York, Pennsylvania, Arkansas and Texas. During the third quarter of 2009, the New York State Department of Taxation and Finance (NYS) commenced an examination of the Company's New York State franchise tax returns for the years 2005 through 2007. In the third quarter of 2010, the examination was completed and resulted in no change to the Company's originally filed returns. Also, during the third quarter of 2010, the Internal Revenue Service commenced an examination of the Company's Federal Income tax returns for years 2008 and 2009. In the first quarter of 2011, the examination was completed and resulted in no material adjustments to the originally filed returns. The 2008 and 2010 federal and state tax returns remain open for potential examination by taxing authorities.

8. Shareholders' Equity

		(\$000's omitted except for share data)							
Common stock						Accumulated			
Number		Capital				Other		Total	
of shares		in		Retained			Comprehensive		Shareholders'
issued	Amount	excess		earnings	ESOP	Treasury	Loss		Equity
		Par	Value			stock			
Balance									
December									
31, 2010	2,614,506	\$523	\$13,491	\$11,467	\$(1,367)	\$(2,724)	\$(78	)	\$21,312
Net									
income	-	-	-	2,038	-	-	-		2,038
Surrender									
of									
unexercised									
stock									
options,									
net of tax									
benefit	-	-	156	(517)	-	-	-		(361)
Cash									
dividend	-	-	-	(336)	-	-	-		(336)
Balance									
September									
30, 2011	2,614,506	\$523	\$13,647	\$12,652	\$(1,367)	\$(2,724)	\$(78	)	\$22,653