

SERVOTRONICS INC /DE/
Form 10-Q
May 14, 2012

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 March 31, 2012

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
(State or other jurisdiction of
incorporation or organization)

16-0837866
(I. R. S.
Employer
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

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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 April 30, 2012
Common Stock, \$.20 par value	2,386,871

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

	March 31, 2012 (Unaudited)	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 5,009	\$ 4,948
Accounts receivable, net	5,671	6,031
Inventories, net	11,747	11,607
Prepaid income taxes	106	133
Deferred income taxes	754	754
Other assets	833	505
Total current assets	24,120	23,978
Property, plant and equipment, net	6,022	6,103
Other non-current assets	344	342
Total Assets	\$ 30,486	\$ 30,423
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	\$ 195	\$ 202
Current portion of capital lease related party	81	81
Accounts payable	1,331	1,451
Accrued employee compensation and benefit costs	1,711	1,434
Other accrued liabilities	183	327
Total current liabilities	3,501	3,495
Long-term debt	2,850	2,855
Long-term portion of capital lease related party	313	333
Deferred income taxes	496	496
Shareholders' equity:		
Common stock, par value \$.20; authorized 4,000,000 shares; issued 2,614,506 shares; outstanding 2,083,257 (2,074,257 - 2011) shares	523	523
Capital in excess of par value	13,774	13,774
Retained earnings	12,507	12,490
Accumulated other comprehensive loss	(67)	(67)
Employee stock ownership trust commitment	(1,266)	(1,266)
Treasury stock, at cost 296,135 (305,135 -2011) shares	(2,145)	(2,210)
Total shareholders' equity	23,326	23,244
Total Liabilities and Shareholders' Equity	\$ 30,486	\$ 30,423

See notes to consolidated financial statements

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

	Three Months Ended	
	March 31,	
	2012	2011
Revenue	\$8,369	\$8,275
Costs, expenses and other income:		
Cost of goods sold, exclusive of depreciation and amortization	6,773	6,209
Selling, general and administrative	1,332	1,297
Interest expense	13	15
Depreciation and amortization	171	167
Other income, net	(8) (10
	8,281	7,678
Income before income tax provision	88	597
Income tax provision	25	179
Net income	\$63	\$418
Income per share:		
Basic		
Net income per share	\$0.03	\$0.21
Diluted		
Net income per share	\$0.03	\$0.19

See notes to consolidated financial statements

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

	Three Months Ended	
	March 31,	
	2012	2011
Net income	\$63	\$418
Other comprehensive income:		
Retirement benefits adjustment	-	-
Total comprehensive income	\$63	\$418

See notes to consolidated financial statements

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

	Three Months Ended	
	March 31,	
	2012	2011
Cash flows related to operating activities:		
Net income	\$63	\$418
Adjustments to reconcile net income to net cash generated (used) in operating activities:		
Depreciation and amortization	171	167
Increase in inventory reserve	14	4
Change in assets and liabilities:		
Accounts receivable	360	(551)
Inventories	(154)	(130)
Prepaid income taxes	27	170
Other assets	(328)	(327)
Other non-current assets	(2)	(6)
Accounts payable	(120)	(44)
Accrued employee compensation and benefit costs	274	231
Other accrued liabilities	(144)	(50)
Net cash generated (used) in operating activities	161	(118)
Cash flows related to investing activities:		
Capital expenditures - property, plant and equipment	(87)	(101)
Net cash used in investing activities	(87)	(101)
Cash flows related to financing activities:		
Principal payments on long-term debt	(12)	(38)
Proceeds from exercise of stock options	19	-
Principal payments on capital lease related party	(20)	(20)
Net cash used in financing activities	(13)	(58)
Net increase (decrease) in cash and cash equivalents	61	(277)
Cash and cash equivalents at beginning of period	4,948	4,447
Cash and cash equivalents at end of period	\$5,009	\$4,170

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 months ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. The consolidated financial statements should be read in conjunction with the 2011 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.

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 \$116,000 at March 31, 2012 and \$101,000 at December 31, 2011.

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. Market provisions in respect of lower of cost or market adjustments 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 \$787,000 and \$773,000 at March 31, 2012 and December 31, 2011, respectively. Pre-production and start-up costs are expensed as incurred.

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

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 March 31, 2012 or December 31, 2011, and did not recognize any interest and/or penalties in its consolidated statements of income during the three months ended March 31, 2012 and 2011.

Supplemental cash flow information

Income taxes paid during the three months ended March 31, 2012 and 2011 amounted to approximately \$7,500 and \$22,000, respectively. Interest paid during the three months ended March 31, 2012 and 2011 amounted to approximately \$13,000 and \$15,000, respectively.

Employee Stock Ownership Plan

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

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in business circumstances indicate, or at least annually, 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 March 31, 2012 and December 31, 2011.

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 11, 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.

Recent Accounting Pronouncements

In June 2011, the FASB issued new accounting guidance related to the presentation of comprehensive income that eliminates the option to present components of other comprehensive income as part of the statement of changes in shareholders' equity. The amendments require that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The

amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. The Company adopted this pronouncement in the first quarter of 2012 and is presenting separate statements of comprehensive income in the consolidated financial statements. For the three month periods ended March 31, 2012 and 2011, there were no items affecting comprehensive income.

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SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3.	Inventories	March 31, 2012	December 31, 2011
		(\$000's omitted)	
	Raw materials and common parts	\$ 5,641	\$ 5,727
	Work-in-process	3,825	3,511
	Finished goods	2,281	2,369
	Total inventories, net of reserve	\$ 11,747	\$ 11,607

4.	Property, Plant and Equipment	March 31, 2012	December 31, 2011
		(\$000's omitted)	
	Land	\$ 25	\$ 25
	Buildings	7,189	7,181
	Machinery, equipment and tooling (including capital lease)	13,010	12,930
		20,224	20,136
	Less accumulated depreciation and amortization	(14,202)	(14,033)
	Total property, plant and equipment	\$ 6,022	\$ 6,103

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 March 31, 2012 and December 31, 2011, accumulated amortization on the building amounted to approximately \$2,455,000 and \$2,423,000, respectively. Amortization expense amounted to \$32,000 for the three month periods ended March 31, 2012 and 2011. 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 a related party. As of March 31, 2012 and December 31, 2011, accumulated amortization on the machinery and equipment amounted to approximately \$203,000 and \$182,000, respectively. Amortization expense amounted to \$21,000 for the three month periods ended March 31, 2012 and 2011. 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 \$115,000 and \$112,000 for the three month periods ended March 31, 2012 and 2011, respectively. The combined depreciation and amortization expense were \$171,000 and \$167,000 for the three month periods ended March 31, 2012 and 2011, respectively.

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5.	Long-Term Debt	March 31, 2012	December 31, 2011
		(\$000's omitted)	
	Industrial Development Revenue Bonds; secured by an equivalent letter of credit from a bank with interest payable monthly at a floating rate (0.47% at March 31, 2012)(A)	\$ 2,960	\$ 2,960
	Secured term loan payable to a government agency; monthly payments of \$1,950 including interest fixed at 3% payable through fourth quarter of 2015	81	86
	Secured term loan payable to a government agency; monthly principal payments of approximately \$2,200 with interest waived payable through second quarter of 2012	4	11
		3,045	3,057
	Less current portion	(195)	(202)
		\$ 2,850	\$ 2,855

(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 March 31, 2012 and December 31, 2011.

Certain lenders require the Company to comply with debt covenants as described in the specific loan documents, including a debt service ratio. At March 31, 2012 and December 31, 2011, 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 March 31, 2012, the present value of the minimum lease payment is approximately \$394,000 (after subtracting approximately \$19,000 of imputed interest).

7. Income Taxes

The Company did not have any material uncertain tax positions or unrecognized tax benefits or obligations as of March 31, 2012 and December 31, 2011.

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SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. 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 through 2011 federal and state tax returns remain open under statute.

8.	Shareholders' Equity							
	(\$000's omitted except for share data)							
	Common stock		Capital in excess of par value		Retained earnings	ESOP	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Number of shares issued	Amount	Treasury Stock	Treasury Stock				
Balance December 31, 2011	2,614,506	\$ 523	\$ 13,774	\$ 12,490	\$(1,266)	\$(2,210)	\$(67)	\$ 23,244
Net income	-	-	-	63	-	-	-	63
Exercise of Stock Options	-	-	-	(46)	-	65	-	19
Balance March 31, 2012	2,614,506	\$ 523	\$ 13,774	\$ 12,507	\$(1,266)	\$(2,145)	\$(67)	\$ 23,326

In January of 2006, the Company's Board of Directors authorized the purchase by the Company of up to 250,000 shares of its common stock in the open market or in privately negotiated transactions. On October 31, 2008, the Company announced that its Board of Directors authorized the purchase of an additional 200,000 shares of the Company's common stock under the Company's current purchase program. As of March 31, 2012, the Company has purchased 238,088 shares and there remain 211,912 shares available to purchase under this program. There were no shares purchased by the Company during the three month periods ended March 31, 2012 and 2011.

During the three month period ended March 31, 2012, one option holder elected to exercise 9,000 options, resulting in 9,000 shares issued out of treasury stock.

Earnings Per Share

Basic earnings per share is computed by dividing net earnings by the weighted average number of shares outstanding during the period. Diluted earnings per share is 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 the earnings per share that were outstanding for the period. Incremental shares from assumed conversions are calculated as the number of shares that would be issued, net of the number of shares that could be purchased in the marketplace with the cash received upon stock option exercise.

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Three Months Ended March 31,	
	2012	2011
	(\$000's omitted except per share data)	
Net income	\$ 63	\$ 418
Weighted average common shares outstanding (basic)	2,077	1,982
Incremental shares from assumed conversions of stock options	44	171
Weighted average common shares outstanding (diluted)	2,121	2,153
Basic		
Net income per share	\$ 0.03	\$ 0.21
Diluted		
Net income per share	\$ 0.03	\$ 0.19

9. Commitments

The Company leases certain equipment and real property pursuant to operating lease arrangements. Total rental expense in the three month periods ended March 31, 2012 and 2011 and future minimum payments under such leases are not material to consolidated financial statements. The Company also leases certain real and personal property being accounted for under capital leases. See also Note 4, Property, Plant and Equipment, Note 5, Long-Term Debt and Note 6, Capital Lease – Related Party, of the accompanying consolidated financial statements for information on the capital leases.

10. Related Party Transactions

During 2009 the Company formed a new wholly owned subsidiary that leased certain personal property from a related party through the execution of a capital lease. See Note 6, Capital Lease-Related Party, of the accompanying consolidated financial statements. The Company also entered into a real property lease agreement, with the same related party, which provides for annual rental of \$60,000. The Company has the option to purchase the building at the appraised value of \$506,000. In addition, in the event the Company is successful in obtaining certain tax and/or other incentives from the state the entity operates in, the Company will be required to purchase the building. The Company did not obtain the incentives and did not exercise its purchase option in 2011 or during the three months ended March 31, 2012. However, during November 2011, the lessor and the Company extended the lease including purchase option through November 2012. Additionally, in the event that the Company purchases the building, there is an arrangement payable to the related party, providing a threshold in annual earnings is reached by the subsidiary, which will result in a percentage payment which could be as low as zero dollars to a maximum total in the aggregate of \$600,000 which is non-recurring. These transactions are disclosed as related party transactions because the wife of the Company's President/COO is the sole shareholder of the company that is leasing/selling the assets.

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. 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 primarily involve the design, manufacture, and marketing of servo-control components (i.e., torque motors, control valves, actuators, etc.) for government, commercial and industrial applications. CPG’s operations involve the design, manufacture and marketing of a variety of cutlery and other edged products for use by consumers and government agencies. The Company derives its primary sales revenue from domestic customers, although a portion of finished products are for foreign end use.

As of March 31, 2012, the Company had identifiable assets of approximately \$30,486,000 (\$30,423,000 – December 31, 2011) of which approximately \$18,405,000 (\$18,004,000 – December 31, 2011) was for ATG and approximately \$12,081,000 (\$12,419,000 – December 31, 2011) was for CPG.

Information regarding the Company’s operations in these segments is summarized as follows (\$000’s omitted):

	ATG		CPG		Consolidated	
	Three Months Ended		Three Months Ended		Three Months Ended	
	March 31,		March 31,		March 31,	
	2012	2011	2012	2011	2012	2011
Revenues from unaffiliated customers	\$ 5,302	\$ 5,116	\$ 3,067	\$ 3,159		