SERVOTRONICS INC /DE/
Form 10QSB
November 14, 2003

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, 2003

--- 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 - 7109

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)

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, 2003
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

PART I FINANCIAL INFORMATION
SERVOTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
September 30, 2003

($000's omitted except per share data)
(Unaudited)

Assets
Current assets:

Cash
Accounts receivable
Inventories
Prepaid income taxes
Deferred income taxes
Other (See Note 1 to consolidated financial statements)

Total current assets

Property, plant and equipment, net

Other assets

Liabilities and Shareholders' Equity
Current liabilities:
  Current portion of long-term debt
  Accounts payable
  Accrued employee compensation and benefit costs
  Other accrued liabilities
  Accrued income taxes

Total current liabilities

Long-term debt

Deferred income taxes

Other non-current liabilities

Shareholders' equity:
  Common stock, par value $.20; authorized 4,000,000 shares; Issued 2,614,506 shares
  Capital in excess of par value
  Retained earnings
  Accumulated other comprehensive loss

  Employee stock ownership trust commitment
  Treasury stock, at cost 121,605 shares

Total shareholders' equity

See notes to consolidated financial statements

SERVOTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS

($000's omitted except per share data)
(Unaudited)

	Three Months Ended September 30, 2003	Three Months Ended September 30, 2002	Nine Se 2003
Net revenues	$ 4,487	$ 3,761	$ 12,261
Costs and expenses:			
Cost of goods sold	3,339	2,739	9,145
Selling, general and administrative	756	804	2,436

Interest	38	49	122
Depreciation and amortization	158	161	509
	4,291	3,753	12,212
Income before income taxes	196	8	49
Income tax provision	73	2	19
Net income	$ 123	$ 6	$ 30
Income Per Share:			
Basic			
Net income per share	$ 0.06	$ -	$ 0.02
Diluted			
Net income per share	$ 0.06	$ -	$ 0.02

See notes to consolidated financial statements

SERVOTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

($000's omitted)
(Unaudited)

	Nine Mo Septe 2003
Cash flows related to operating activities:	
Net income	$ 30
Adjustments to reconcile net income to net cash provided by operating activities -	
Depreciation and amortization	509
Change in assets and liabilities -	
Accounts receivable	30
Inventories	(419)
Other current assets	(291)
Other assets	5
Accounts payable	359
Accrued employee compensation & benefit costs	91
Accrued income taxes	115
Other accrued liabilities	142
Net cash provided by operating activities	571

Cash flows related to investing activities:	
Capital expenditures - property, plant & equipment	(113)
Net cash used in investing activities	(113)
Cash flows related to financing activities:	
Increase in demand loan	250
Payments on demand loan	(250)
Principal payments on long-term debt	(156)
Net cash used in financing activities	(156)
Net increase (decrease) in cash	302
Cash at beginning of period	679
Cash at end of period	$ 981

See notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
($000 omitted in tables except for per share data)

The information set forth herein is unaudited. This financial information reflects all normal accruals and adjustments which, in the opinion of management, are necessary for a fair statement of the results for the periods presented.

1. Summary of significant accounting policies

Revenue recognition

The Company's revenues are principally recognized as units are shipped and as terms and conditions of purchase orders are met. The Company also incurred costs for certain contracts which are long term. These contracts are accounted for under the percentage of completion method (cost-to-cost) which recognizes revenue as the work progresses towards completion.

Included in other current assets are $985,000 of unbilled revenues which represent revenue earned under the percentage of completion method (cost-to-cost) not yet billable under the terms of the contracts.

2. Inventories

	September 30, 2003
Raw materials and common parts	$ 1,083
Work-in-process	5,415
Finished goods	920

	7,418
Less common parts expected to be used after one year	(236)
	$ 7,182

3. Property, plant and equipment

	September 30, 2003
Land	$ 25
Buildings	6,452
Machinery, equipment and tooling	9,724
	16,201
Less accumulated depreciation	(9,516)
	$ 6,685

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. 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.

4. Long-term debt

	September 30, 2003
Industrial Development Revenue Bonds; secured by a letter of credit from a bank with interest payable monthly at a floating rate (1.44% at September 30, 2003)	$ 4,490
Term loans; payable to a financial institution; $500,000 at LIBOR plus 2% (3.11% at September 30, 2003); quarterly principal payments of $17,500 commencing January 1, 2005; payable in full October 1, 2009; and $357,000 at a rate of 3.40% at September 30, 2003; quarterly principal payments of $35,714 through February 1, 2006	857
Various other secured term notes payable to government agencies	549
	5,896
Less current portion	(378)
	$ 5,518

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.

The Company also has a $1,000,000 line of credit on which there was no balance outstanding at September 30, 2003.

5. Common shareholders' equity

	Common stock						
	Number of shares issued	Amount	Capital in excess of par value	Retained earnings	ESOP	Treasury stock	Compreh inco
Balance December 31, 2002	2,614,506	$523	$13,361	$1,262	($ 2,337)	($ 1,054)	
Comprehensive income							
Net income	-	-	-	$ 30	-	-	$ 3
Other comprehensive income, net of tax	-	-	-	-	-	-	-
Minimum pension liability adjustment	-	-	-	-	-	-	-
Other comprehensive income	-	-	-	-	-	-	-
Comprehensive income	-	-	-	-	-	-	$ 3
Compensation expense	-	-	-	-	-	-	
Treasury shares issued for deferred compensation obligation	-	-	(328)		-	534	
Balance September 30, 2003	2,614,506	$523	$13,033	$1,292	($ 2,337)	($ 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 September 30, 2003	2002	Nine M Sept 2003
Net income	$ 123	$ 6	$ 30
Weighted average common shares outstanding (basic)	2,022	1,894	1,989
Incremental shares from assumed conversions of stock options	7	1	4
Weighted average common shares outstanding (diluted)	2,029	1,895	1,993
Basic			
Net income per share	$ 0.06	$ 0.00	$ 0.02
Diluted			
Net income per share	$ 0.06	$ 0.00	$ 0.02

6. Business segments

The Company operates in two business segments, Advanced Technology Group and Consumer Products Group. 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 Advanced Technology Group primarily involve the design, manufacture, and marketing of servo-control components for government and commercial industrial applications. Consumer Products Group'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.

Nine Month Period Ended September 30, 2003	Advanced Technology Group	Consumer Products Group
Revenues from unaffiliated customers	$ 7,514	$ 4,747
Profit	$ 1,052	$ 7
Depreciation and amortization		
Interest expense		
General corporate expense		
Income before income taxes		

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

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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 September 30, 2003	2002	Period to period $ increase (decrease) 03-02	Relations net reve nine month Septembe 2003
Net revenues				
Advanced technology products	56.2%	63.0%	6.4%	61.3%
Consumer products	43.8%	37.0%	41.2%	38.7%
	100.0%	100.0%	19.3%	100.0%
Cost of goods sold, exclusive of depreciation	74.4%	72.8%	21.9%	74.6%
Gross profit	25.6%	27.2%	12.3%	25.4%
Selling, general and administrative	16.8%	21.4%	(6.0%)	19.9%
Interest	0.8%	1.3%	(22.4%)	1.0%
Depreciation and amortization	3.5%	4.3%	(1.9%)	4.2%
	21.1%	27.0%	6.1%	25.1%
Income before income taxes	4.5%	0.2%	2350.0%	0.3%
Income tax provision	1.8%	-	3550.0%	0.1%
Net income	2.7%	0.2%	1950.0%	0.2%

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Management Discussion

During the nine month period ended September 30, 2003 and for the comparable period ended September 30, 2002, approximately 39% and 23% respectively, of the Company's revenues were derived from contracts with agencies of the U.S. Government or their prime contractors. The Company's business is performed under fixed price contracts. Sales to the government are affected by defense budgets, U.S. & foreign policy and the level of military operations. As major international events continue to unfold, it is difficult to predict the impact of these events on future financial results. In addition, the continued real and perceived threats to the airline industry have lowered post-9/11 commercial passenger traffic and have had a direct adverse effect on revenues in the commercial aerospace markets and, consequently, on aerospace manufacturing.

Results of Operations

The Company's consolidated results of operations for the three month period ended September 30, 2003, when compared to same three month period of 2002 showed a 19.3% increase in net revenues (approximately $726,000) and a 1950.0% increase in net income (approximately $117,000). For the nine month period ended September 30, 2003 when compared to the same nine month period of 2002 net revenues increased $366,000 while net income decreased $215,000. The increases in revenues for the nine month period and quarter ended September 30, 2003 are primarily attributed to increases in government sales at the Advanced Technology Group (ATG) and the Consumer Products Group (CPG). Significant production shipments of the previously reported contract for the new U.S. Marine Corps' combination combat knife and bayonet commenced in the third quarter of 2003. While revenues are still being adversely affected by the overall economic softness in the commercial aerospace industry, the Company continues to be successful in procuring new applications while maintaining a strong backlog.

Notwithstanding the immediate expensing of front-end costs associated with prototype, preproduction and start-up activities at both the ATG and CPG (i.e., in advance of the costs being matched with their anticipated related sales), the Company generated significantly improved results in the third quarter of 2003.

Selling, general and administrative expenses increased as a percentage of revenues for the nine month period and decreased for the quarter ended September 30, 2003 when compared to the same period in 2002. The Company has incurred expenses for costs dedicated to expanded sales and marketing activities and additional procedure and professional costs relative to the financial reporting and corporate disclosure requirements of the Sarbanes-Oxley Act.

Interest expense decreased for both the nine month period and the quarter ended September 30, 2003 when compared to the same period in 2002 due to market driven interest rate fluctuations and the decrease of institutional debt.

The Company's current effective tax rate is approximately 39%.

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Liquidity and Capital Resources

The Company's primary liquidity and capital requirements relate to the 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 have been from positive cash flow from operations and from bank financing.

The Company also has a $1,000,000 line of credit on which there was no balance outstanding at September 30, 2003.

As of September 30, 2003 there are no material commitments for capital expenditures.

Item 3. DISCLOSURE CONTROLS AND PROCEDURES

Our management has reviewed our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15 and 15d-15). Our management believes that as of the end of the Company's most recent fiscal quarter, such disclosure controls and procedures are adequate to ensure that material information relating to the Company is made known to management by others within the Company.

In addition, our management reviewed our internal controls and, to management's knowledge, there have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the date of their last evaluation.

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 3, 2003. 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	2,306,985	7,227
Nicholas D. Trbovich, Jr	2,306,985	7,227
Dr. William H. Duerig.	2,305,109	9,103
Donald W. Hedges	2,305,109	9,103

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) 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.

(b) Reports on Form 8-K

An 8-K was filed on August 14, 2003 incorporating the Press Release of Servotronics, Inc. dated August 13, 2003.

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 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 7, 2003

SERVOTRONICS, INC.

By: /s/Lee D. Burns, Treasurer
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Lee D. Burns, Treasurer and
Chief Financial Officer

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

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