

SERVOTRONICS INC /DE/
Form 10-Q
November 13, 2008

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2008

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 registrant as specified in its charter)

Delaware
(State or other jurisdiction of
(IRS Employer
incorporation or
organization)

16-0837866

Identification No.)

1110 Maple Street, Elma, New York 14059-0300
(Address of principal executive offices)

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 Exchange Act of 1934 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 ; 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, 2008

Common Stock, \$.20 par value

2,238,316

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PART I. FINANCIAL INFORMATION

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

| | September 30, 2008 (Unaudited) | December 31, 2007 |
|--|---|-------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 4,088 | \$ 4,879 |
| Accounts receivable | 4,975 | 4,570 |
| Inventories | 9,284 | 8,011 |
| Deferred income taxes | 411 | 411 |
| Other assets | 874 | 572 |
| Total current assets | 19,632 | 18,443 |
| Property, plant and equipment, net | 5,752 | 5,870 |
| Other non-current assets | 211 | 218 |
| | \$ 25,595 | \$ 24,531 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 387 | \$ 387 |
| Accounts payable | 1,621 | 1,419 |
| Accrued employee compensation and benefit costs | 1,560 | 1,278 |
| Accrued income taxes | 535 | 489 |
| Other accrued liabilities | 298 | 298 |
| Total current liabilities | 4,401 | 3,871 |
| Long-term debt | 4,080 | 4,242 |
| Deferred income taxes | 412 | 412 |
| Shareholders' equity: | | |
| Common stock, par value \$.20; authorized 4,000,000 shares; issued 2,614,506 shares; outstanding 1,905,797 (1,933,797 – 2007) shares | 523 | 523 |
| Capital in excess of par value | 13,033 | 13,033 |
| Retained earnings | 7,673 | 6,753 |
| Accumulated other comprehensive loss | (67) | (67) |
| | 21,162 | 20,242 |
| Employee stock ownership trust commitment | (1,832) | (1,832) |
| Treasury stock, at cost 363,404 (335,404 – 2007) shares | (2,628) | (2,404) |
| Total shareholders' equity | 16,702 | 16,006 |
| | \$ 25,595 | \$ 24,531 |

See notes to consolidated financial statements

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|----------|------------------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Revenues | \$ 7,818 | \$ 8,464 | \$ 24,535 | \$ 23,368 |
| Costs, expenses and other income: | | | | |
| Cost of goods sold, exclusive of depreciation | 5,568 | 6,565 | 17,653 | 18,159 |
| Selling, general and administrative | 1,139 | 1,018 | 3,183 | 2,940 |
| Interest | 42 | 62 | 129 | 188 |
| Depreciation and amortization | 129 | 129 | 410 | 409 |
| Other income, net | (14) | (33) | (67) | (104) |
| | 6,864 | 7,741 | 21,308 | 21,592 |
| Income before income tax provision | 954 | 723 | 3,227 | 1,776 |
| Income tax provision | 349 | 247 | 1,181 | 657 |
| Net income | \$ 605 | \$ 476 | \$ 2,046 | \$ 1,119 |
| Income per share: | | | | |
| Basic | | | | |
| Net income per share | \$ 0.31 | \$ 0.25 | \$ 1.06 | \$ 0.58 |
| Diluted | | | | |
| Net income per share | \$ 0.29 | \$ 0.22 | \$ 0.96 | \$ 0.53 |

See notes to consolidated financial statements

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

| | Nine Months Ended September 30, | |
|--|------------------------------------|----------|
| | 2008 | 2007 |
| Cash flows related to operating activities: | | |
| Net income | \$ 2,046 | \$ 1,119 |
| Adjustments to reconcile net income to net cash provided by operating activities - | | |
| Depreciation and amortization | 410 | 409 |
| Change in assets and liabilities - | | |
| Accounts receivable | (405) | (271) |
| Inventories | (1,273) | (718) |
| Other assets | (302) | (243) |
| Other non-current assets | 7 | 134 |
| Accounts payable | 202 | 188 |
| Accrued employee compensation and benefit costs | 282 | 622 |
| Accrued income taxes | 46 | (26) |
| Other accrued liabilities | - | 1 |
| Net cash provided by operating activities | 1,013 | 1,215 |
| Cash flows related to investing activities: | | |
| Capital expenditures - property, plant and equipment | (287) | (207) |
| Net cash used in investing activities | (287) | (207) |
| Cash flows related to financing activities: | | |
| Principal payments on long-term debt | (165) | (161) |
| Purchase of treasury shares | (239) | (804) |
| Cash dividend | (348) | - |
| Purchase of stock options | (772) | - |
| Proceeds from exercise of stock options | 7 | - |
| Net cash used in financing activities | (1,517) | (965) |
| Net (decrease) increase in cash and cash equivalents | (791) | 43 |
| Cash and cash equivalents at beginning of period | 4,879 | 4,104 |
| Cash and cash equivalents at end of period | \$ 4,088 | \$ 4,147 |

See notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. 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 U.S. 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, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. The consolidated financial statements should be read in conjunction with the annual report and the notes thereto.

2. Summary of significant accounting policies

Principles of consolidation

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

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.

Revenue recognition

Revenues are recognized as services are rendered or as units are shipped at the designated FOB point consistent with the transfer of title, risks and rewards of ownership. 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 and may provide for progress payments based on in-process costs as they are incurred.

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 with respect to 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 \$527,000 and \$646,000 at September 30, 2008 and December 31, 2007, respectively. Pre-production and start-up costs are expensed as incurred.

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 on the statements of operations as other income, net.

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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 accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes". SFAS No. 109 requires the recognition of 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 bases of assets and liabilities. The Company and its subsidiaries file a consolidated federal income tax return, combined New York and standalone Pennsylvania state income tax returns.

Supplemental cash flow information

Income taxes paid during the three months ended September 30, 2008 and 2007 amounted to approximately \$9,000 and \$399,000, respectively, and amounted to \$1,153,000 and \$700,000 for the nine months ended September 30, 2008 and 2007, respectively. Interest paid during the three months ended September 30, 2008 and 2007 amounted to approximately \$35,000 and \$62,000, respectively, and amounted to \$137,000 and \$187,000 for the nine months September 30, 2008 and 2007, respectively.

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, 2008 and December 31, 2007.

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.

Research and development costs

Research and development costs are expensed as incurred as defined in SFAS No. 2, "Accounting for Research and Development Costs."

New accounting pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157 "Fair Value Measurement". This Statement defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. In February of 2008, the FASB issued FASB Staff Position 157-2 which delays the effective date of SFAS 157 for non-financial assets and liabilities which are not measured at fair value on a recurring basis (at least annually) until fiscal years beginning after November 15, 2008. The Company is currently evaluating the impact of SFAS 157 on the Company's consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48 “Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109” (“FIN 48”). This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, “Accounting for Income Taxes”. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of FIN 48 in the first quarter of fiscal 2007. The adoption of FIN 48 did not have a material impact on the Company's financial position, results of operations or cash flows.

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, 2008 or December 31, 2007, and did not recognize any interest and/or penalties in its consolidated statements of operations during the three or nine month periods ended September 30, 2008 and 2007.

In February 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (“SFAS No. 159”). SFAS No.159 permits companies to elect to follow fair value accounting for certain financial assets and liabilities in an effort to mitigate volatility in earnings without having to apply complex hedge accounting provisions. The standard also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company elected not to adopt the provisions of FAS 159 on the Company’s consolidated financial statements.

Other recently issued FASB Statements or Interpretations, SEC Staff Accounting Bulletins, and AICPA Emerging Issue Task Force Consensuses have either been implemented or are not applicable to the Company.

Risk Factors

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, competition from expanding manufacturing capabilities and technical sophistication of low-cost developing countries, particularly in South and East Asia, currency policies in relation to the U.S. dollar of some major foreign exporting countries so as to maintain or increase a pricing advantage of their exports vis-à-vis U.S. manufactured goods, the effects of terrorism, including the threat 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.

Financial instruments that potentially subject the Company to concentration of credit risks principally consist of cash and cash equivalents. The Company places its cash and cash equivalents with financial institutions and at times, such cash and cash equivalents may be in excess of the current (as of October 31, 2008) Federal Deposit Insurance Corporation’s aggregate insurance limits of \$1,500,000 (\$250,000 per financial institution).

3. Inventories

| | September 30, 2008 | December 31, 2007 |
|--|-----------------------|----------------------|
| | (\$000's omitted) | |
| Raw materials and common parts, net of reserve | \$ 2,789 | \$ 2,361 |
| Work-in-process | 5,269 | 4,532 |
| Finished goods | 1,226 | 1,118 |
| | \$ 9,284 | \$ 8,011 |

4. Property, plant and equipment

| | September 30, 2008 | December 31, 2007 |
|--|-----------------------|----------------------|
| | (\$000's omitted) | |
| Land | \$ 25 | \$ 25 |
| Buildings | 6,679 | 6,638 |
| Machinery, equipment and tooling | 11,582 | 11,336 |
| | 18,286 | 17,999 |
| Less accumulated depreciation and amortization | (12,534) | (12,129) |
| | \$ 5,752 | \$ 5,870 |

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, 2008 and December 31, 2007, accumulated amortization on the building amounted to approximately \$1,989,000 and \$1,883,000, respectively. The associated current and long-term liabilities are discussed in Note 5, Long-term debt, of the consolidated financial statements. Depreciation expense for the three months ended September 30, 2008 and 2007 amounted to \$129,000 for both periods and \$410,000 and \$409,000 for the nine months ended September 30, 2008 and 2007, 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.

5. Long-term debt

| | September 30, 2008 | December 31, 2007 |
|---|--------------------------|-------------------------|
| | (\$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 (8.16% at September 30, 2008, 2.02% at 10/31/08)(A) | \$ 3,640 | \$ 3,640 |
| Term loan payable to a financial institution; interest at LIBOR plus 2%, (4.79% at September 30, 2008); quarterly principal payments of \$26,786 through the fourth quarter of 2011 | 348 | 428 |
| Term loan payable to a financial institution; interest at LIBOR plus 2%, not to exceed 6.00% (5.88% at September 30, 2008); quarterly principal payments of \$17,500; payable in full in the fourth quarter of 2009; partially secured by equipment | 238 | 290 |
| Secured term loan payable to a government agency; monthly payments of \$1,950 including interest fixed at 3% payable through fourth quarter of 2015 | 151 | 165 |
| Secured term loan payable to a government agency; monthly principal payments of approximately \$1,800 with interest waived payable through second quarter of 2012 | 90 | 106 |
| | 4,467 | 4,629 |
| Less current portion | (387) | (387) |
| | \$ 4,080 | \$ 4,242 |

(A) 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, 2008 and December 31, 2007.

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, 2008 and December 31, 2007, the Company was in compliance with all of its debt covenants.

6. Income taxes

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109 (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company adopted FIN 48 as of the beginning of 2007 and the adoption of FIN 48 did not have a material impact on its consolidated financial statements. The Company did not have any unrecognized tax benefits or obligations as of September 30, 2008 and December 31, 2007.

If interest and penalties would need to be accrued related to unrecognized tax obligations, it is the Company's policy to recognize interest and penalties accrued related to unrecognized tax obligations as a component of income taxes. The Company and/or its subsidiaries file income tax returns in the United States federal jurisdiction, New York State and Pennsylvania. The Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2005.

In May 2007, the FASB issued FASB Staff Position ("FSP") FIN 48-1 Definition of Settlement in FASB Interpretation No. 48 (FSP FIN 48-1). FSP FIN 48-1 provides guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FSP FIN 48-1 is effective retroactively to January 1, 2007. The implementation of this standard did not have a material impact on the Company's consolidated financial position or results of operations.

During the second quarter of 2007, the Internal Revenue Service (IRS) commenced an examination of the Company's U.S. income tax return for the year 2005. In the third quarter of 2007, the IRS examination was completed and settled resulting in a \$3,000 refund to the Company.

7. Common shareholders' equity

| | Common stock | | (\$000's omitted) | | | | | Other comprehensive loss | Total shareholders' equity |
|-----------------------------|-------------------------|--------|--------------------------------|-------------------|------------|----------------|---------|--------------------------|----------------------------|
| | Number of shares issued | Amount | Capital in excess of par value | Retained earnings | ESOP | Treasury stock | | | |
| Balance December 31, 2007 | 2,614,506 | \$ 523 | \$ 13,033 | \$ 6,753 | (\$ 1,832) | (\$ 2,404) | (\$ 67) | \$ 16,006 | |
| Net income | - | - | - | 2,046 | - | - | - | 2,046 | |
| Cash dividend | - | - | - | (348) | - | - | - | (348) | |
| Purchase of stock options | - | - | - | (772) | - | - | - | (772) | |
| Exercise of stock options | - | - | - | (8) | - | 15 | - | 7 | |
| Purchase of treasury shares | - | - | - | - | - | (239) | - | (239) | |
| Other | - | - | - | 2 | - | - | - | 2 | |
| Balance September 30, 2008 | 2,614,506 | \$ 523 | \$ 13,033 | \$ 7,673 | (\$ 1,832) | (\$ 2,628) | (\$ 67) | \$ 16,702 | |

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. As of September 30, 2008, the Company has purchased 224,357 shares and there remain 25,643 shares available to purchase under this program. There were 30,000 shares purchased pursuant to this authorization in the quarter ended September 30, 2008.

As previously reported, on January 31, 2008, the Company announced that its Board of Directors declared a \$0.15 per share cash dividend. The dividend was paid on March 14, 2008 to shareholders of record on February 20, 2008 and was approximately \$348,000 in the aggregate. This dividend does not represent that the Company will pay dividends

on a regular or scheduled basis.

As previously reported, and consistent with the Company's current policy to reduce the number of outstanding Company shares thereby increasing the reported earnings per share, the Company reduced the number of stock options outstanding through a cash payment equal to the difference between the option exercise price and the average of the high and the low market price of the Company's common stock on the day of surrender less an administrative charge.

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. 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.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---------|------------------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| | (\$000's omitted except per share data) | | | |
| Net income | \$ 605 | \$ 476 | \$ 2,046 | \$ 1,119 |
| Weighted average common shares | | | | |
| outstanding (basic) | 1,926 | 1,908 | 1,932 | 1,943 |
| Incremental shares from assumed | | | | |
| conversions of stock options | 188 | 219 | 201 | 184 |
| Weighted average common shares outstanding (diluted) | 2,114 | 2,127 | 2,133 | 2,127 |
| Basic | | | | |
| Net income per share | \$ 0.31 | \$ 0.25 | \$ 1.06 | \$ 0.58 |
| Diluted | | | | |
| Net income per share | \$ 0.29 | \$ 0.22 | \$ 0.96 | \$ 0.53 |

8. 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 the ATG 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 products for use by consumers and various government agencies. The Company derives its primary sales revenue from domestic customers, although a portion of finished products are for foreign end use.

Information regarding the Company's operations in these segments is summarized as follows

(\$000's omitted):

| Advanced Technology Group | | Consumer Products Group | | Consolidated Nine months ended | |
|------------------------------------|-----------|------------------------------------|-----------|--------------------------------------|-----------|
| Nine months ended September 30, | | Nine months ended September 30, | | September 30, | |
| 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| \$ 15,313 | \$ 12,501 | \$ 9,222 | \$ 10,867 | \$ 24,535 | \$ 23,368 |

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Revenues from unaffiliated customers

| | | | | | | |
|------------------------------------|----------|----------|----------|----------|----------|----------|
| Profit | \$ 4,217 | \$ 2,629 | \$ 191 | \$ 139 | \$ 4,408 | \$ 2,768 |
| Interest expense | \$ (117) | \$ (170) | \$ (12) | \$ (18) | (129) | (188) |
| Depreciation and amortization | \$ (287) | \$ (285) | \$ (123) | \$ (124) | (410) | (409) |
| Other income, net | \$ 47 | \$ 82 | \$ 20 | \$ 22 | 67 | 104 |
| General corporate expense | | | | | (709) | (499) |
| Income before income tax provision | | | | | \$ 3,227 | \$ 1,776 |
| Capital expenditures | \$ 249 | \$ 115 | \$ 38 | \$ 92 | \$ 287 | \$ 207 |

| | September 30, 2008 | December 31, 2007 | September 30, 2008 | December 31, 2007 | September 30, 2008 | December 31, 2007 |
|---------------------|--------------------------|-------------------------|--------------------------|-------------------------|--------------------------|-------------------------|
| Identifiable assets | \$ 16,032 | \$ 15,685 | \$ 9,563 | \$ 8,846 | \$ 25,595 | \$ 24,531 |

| | Advanced Technology Group | | Consumer Products Group | | Consolidated Three months ended | |
|--------------------------------------|-------------------------------------|----------|-------------------------------------|----------|---------------------------------------|----------|
| | Three months ended September 30, | | Three months ended September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Revenues from unaffiliated customers | \$ 5,419 | \$ 4,115 | \$ 2,399 | \$ 4,349 | \$ 7,818 | \$ 8,464 |
| Profit (loss) | \$ 1,476 | \$ 758 | \$ (129) | \$ 290 | \$ 1,347 | \$ 1,048 |
| Interest expense | \$ (39) | \$ (56) | \$ (3) | \$ (6) | (42) | (62) |
| Depreciation and amortization | \$ (92) | \$ (92) | \$ (37) | \$ (37) | (129) | (129) |
| Other income, net | \$ 11 | \$ 25 | \$ 3 | \$ 8 | 14 | 33 |
| General corporate expense | | | | | (236) | (167) |
| Income before income tax provision | | | | | \$ 954 | \$ 723 |
| Capital expenditures | \$ 81 | \$ 49 | \$ 20 | \$ 28 | \$ 101 | \$ 77 |

9. Other income

Components of other income include interest income on cash and cash equivalents, and other minor amounts not directly related to the sale of the Company's products.

10. Subsequent Events

On October 31, 2008, the Company's 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. See also Note 7, Common Shareholder' Equity.

Item MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF 2. OPERATIONS

Management Discussion

During the three and nine month periods ended September 30, 2008 and 2007 approximately 37% (52% - 2007) and 41% (45% - 2007) of the Company's revenues were derived from contracts with agencies of the U.S. Government or their prime contractors and their subcontractors. The Company believes that government involvement in military operations overseas will continue to have a direct impact on the financial results in both the Advanced Technology and Consumer Products markets. While the Company remains optimistic in relation to these opportunities, it recognizes that sales to the 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, the effects of terrorism and the threat of terrorism, market demand and acceptance both for the Company's products and its customers' products which incorporate Company-made components.

The Aerospace Industries Association (AIA) and various other sources earlier indicated that the aircraft market continues to be strong based on current aircraft backlog and aircraft order rates, which have remained so in 2008. The Company's Advanced Technology Group revenue increased for the three and nine months ended September 30, 2008 compared to the same period in 2007 due to a general increase attributable to existing and new customers as well as across various product lines. The ATG continues its aggressive business development efforts in its primary markets and is broadening its focus to include new – both domestic and foreign - markets that are consistent with its core competencies.

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The Company's Consumer Products Group develops products for government and commercial applications. Based upon forecasted procurements the Company anticipates that the volatility in government procurement of certain CPG products will continue beyond 2008.

See also Note 8, Business segments, of the consolidated financial statements for information concerning business segment operating results.

Results of Operations

The following table sets forth for the period indicated the percentage relationship of certain items in the consolidated statement of operations to revenues and the period to period dollar (\$000's omitted) and percentage increase or decrease of such items as compared to the indicated prior period.

| | Relationship to net revenues three months ended September 30, 2008 | | Period to period \$ increase (decrease) 08-07 | | Relationship to net revenues nine months ended September 30, 2008 | | Period to period \$ increase (decrease) 08-07 | | Period to period % increase (decrease) 08-07 | |
|---|--|-------|---|--------|---|-------|---|--------|--|--|
| Revenues | | | | | | | | | | |
| Advanced Technology Group | 69.3% | 48.6% | \$ 1,304 | 31.7% | 62.4% | 53.5% | \$ 2,812 | 22.5% | | |
| Consumer Products Group | 30.7 | 51.4 | (1,950) | (44.8) | 37.6 | 46.5 | (1,645) | (15.1) | | |
| | 100.0 | 100.0 | (646) | (7.6) | 100.0 | 100.0 | 1,167 | 5 | | |
| Cost of goods sold, exclusive of depreciation | 71.2 | 77.6 | (997) | (15.2) | 72.0 | 77.7 | (506) | (2.8) | | |
| Gross profit | 28.8 | 22.4 | 351 | 18.5 | 28.0 | 22.3 | 1,673 | 32.1 | | |
| Selling, general and administrative | 14.6 | 12.0 | 121 | 11.9 | 13.0 | 12.6 | 243 | 8.3 | | |
| Interest | 0.5 | 0.7 | (20) | (32.3) | 0.5 | 0.8 | (59) | (31.4) | | |
| Depreciation and amortization | 1.7 | 1.5 | 0 | 0.0 | 1.7 | 1.8 | 1 | 0.2 | | |
| Other income, net | (0.2) | (0.4) | 19 | (57.6) | (0.3) | (0.4) | 37 | (35.6) | | |
| | 16.6 | 13.8 | 120 | 10.2 | 14.9 | 14.8 | 222 | 6.5 | | |
| Income before income tax provision | 12.2 | 8.6 | 231 | 32.0 | 13.1 | 7.5 | 1,451 | 81.7 | | |
| Income tax provision | 4.5 | 3.0 | 102 | 41.3 | 4.8 | 2.7 | 524 | 79.8 | | |
| Net income | 7.7% | 5.6% | \$ 129 | 27.1% | 8.3% | 4.8% | \$ 927 | 82.8% | | |

The Company's consolidated revenues increased approximately \$1,167,000 for the nine month period ended September 30, 2008 when compared to the same nine month period in 2007 while the Company's consolidated revenues decreased approximately \$646,000 for the three month period ended September 30, 2008 when compared to

the same three month period in 2007. During the three and nine month periods ended September 30, 2008, sales of the Company's ATG products for both government and commercial applications increased when compared to the same periods of 2007. These increases were offset by decreased sales at the Company's CPG group for the same three and nine month periods primarily as a result of volatility in procurement of government contracts.

As shown in the above table, gross profit and gross profit as a percentage of net revenues for the three and nine month periods ended September 30, 2008 increased as compared to the same three and nine month periods in 2007. Increased sales volume at the ATG combined with the current mix of products sold in the period within the ATG and CPG segments as well as the composition of ATG and CPG sales to the total consolidated sales directly attributed to dollar value and percentage increase in gross profit. The increases in revenues and margins at the ATG segment were partially offset by gross margin decreases at the CPG segment during the three month period as a result of decreased sales volume due to the completion of certain significant Government contracts.

Selling, general and administrative (SG&A) expenses increased by approximately 8.3% for the nine month period ended September 30, 2008 when compared to the same nine month period in 2007 while the three month period ended September 30, 2008 showed an 11.9% increase when compared to the same three month period in 2007. The increase in SG&A is primarily due to increased expenses associated with business development activities, increased employee compensation and 404 related implementation expenses.

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Interest expense decreased for the three and nine month periods ended September 30, 2008 when compared to the same three and nine month periods in 2007 as average debt outstanding was lower and will continue to decline as the Company repays its scheduled debt obligations and assuming the Company does not incur additional debt and the average industry lending rate does not increase. See also Note 5, Long-Term Debt, of the consolidated financial statements for information on long-term debt.

Depreciation and amortization expense remained relatively consistent for the three and nine month periods ended September 30, 2008 when compared to the same three and nine month periods in 2007. Depreciation expense is affected by the variable estimated useful lives of depreciable property (as identified in Note 2, "Summary of Significant Accounting Policies" of the consolidated financial statements) as well as the timing amount and nature of capital expenditures and their full amortization date thereof.

The Company's effective tax rate was 36.6% in the third quarter of 2008 as compared to 37.0% for the nine month period ended September 30, 2007. The effective tax rate in both years reflects state income taxes, permanent non-deductible expenditures and the tax benefit for manufacturing deductions allowable under the American Jobs Creation Act of 2004 as well as reductions in New York State's statutory tax rate and income apportionments formula. See also Note 6, Income taxes, of the consolidated financial statements for information concerning income tax.

Net income increased \$129,000 and \$927,000 respectively, when comparing the three and nine month periods ended September 30, 2008 to the same three and nine months periods in 2007. The increase in income is the result of increased sales at the ATG for products with favorable margins as well as cost containment activities and a reduction in the effective income tax rate.

Liquidity and Capital Resources

The Company's primary liquidity and capital requirements relate to working capital needs; primarily inventory, accounts receivable, capital expenditures for property, plant and equipment and principal and interest payments on debt.

At September 30, 2008, the Company had working capital of approximately \$15.2 million of which approximately \$4.1 million was comprised of cash and cash equivalents. The Company generated approximately \$1,009,000 in cash from operations during the nine months ended September 30, 2008 as compared to \$1,215,000 during the nine months ended September 30, 2007. Cash was generated from operations through an increase in net income as previously discussed as well as increases in certain employee benefit accrual items. The primary reasons for the increase in the uses of cash for the Company's operating activities for nine month period ended September 30, 2008 was related to payments of approximately \$1,153,000 in income taxes and increases in accounts receivable and inventory costs aggregating \$1,678,000 attributed to the increase in revenue volume.

The Company's primary use of cash in its financing and investing activities in the first nine months of 2008 related to capital expenditures for equipment, principal payments on long-term debt as well as approximately \$348,000 in a cash dividend paid on March 14, 2008 to shareholders of record on February 20, 2008. The Company also expended \$1,010,000 to purchase outstanding stock options and treasury shares.

At September 30, 2008, there are no material commitments for capital expenditures.

The Company also has a \$1,000,000 line of credit on which there is no balance outstanding at September 30, 2008. If needed, this can be used to fund cash flow requirements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and is not required to provide the information required under this item.

Item 4T. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

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 as of September 30, 2008. 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.

Changes in Internal Controls

During the three and nine month periods ended September 30, 2008, there were no changes in internal controls over financial reporting that have materially affected, or are reasonably likely to affect, the Company's internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

None.

Item 1A. RISK FACTORS

The Company is a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and is not required to provide the information required under this item.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Purchases of Equity Securities by the Company and Affiliated Purchasers

| Period | Total Number of Shares Purchased | Average Price \$ Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Maximum Number of Shares that may yet be Purchased under |
|--------|---|------------------------------------|---|---|
|--------|---|------------------------------------|---|---|

| | | | or Programs | the Plans or Programs |
|-------------------------------------|--------|------|-------------|--------------------------|
| July 1 – July 31, 2008 | - | - | - | 55,643 |
| August 1 – August 31, 2008 | - | - | - | 55,643 |
| September 1 – September 30, 2008 | 30,000 | 7.88 | 30,000 | 25,643 |
| Total | 30,000 | 7.88 | 30,000 | 25,643 |

Item 3. **DEFAULTS UPON SENIOR SECURITIES**

None.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The annual meeting of shareholders of the Registrant was held on July 3, 2008. 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 | 1,989,403 | 107,839 |
| Nicholas D. Trbovich, Jr. | 1,989,857 | 107,385 |
| Dr. William H. Duerig. | 2,089,348 | 7,894 |
| Donald W. Hedges | 2,089,802 | 7,440 |

Item 5. OTHER INFORMATION

None.

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-Q 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-Q. 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

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

Date: November 13, 2008

SERVOTRONICS, INC.

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

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

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