

SERVOTRONICS INC /DE/  
Form 10-Q  
November 13, 2012

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549  
Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 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 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).

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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,<br>2012 |
|----------------------------------|------------------------------------|
| Common Stock, \$.20 par<br>value | 2,378,236                          |

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

|   | September<br>30,<br>2012<br>(Unaudited) | December 31,<br>2011 |
|---|---|----------------------|
| Assets  |   |                      |
| Current assets:   |   |                      |
| Cash and cash equivalents   | \$5,547                                 | \$ 4,948             |
| Accounts receivable, net  | 5,372                                   | 6,031                |
| Inventories, net  | 11,406                                  | 11,607               |
| Prepaid income taxes  | 458                                     | 133                  |
| Deferred income taxes   | 754                                     | 754                  |
| Other assets  | 711                                     | 505                  |
| Total current assets  | 24,248                                  | 23,978               |
| Property, plant and equipment, net  | 5,614                                   | 6,103                |
| Other non-current assets  | 364                                     | 342                  |
| Total Assets  | \$30,226                                | \$ 30,423            |
| Liabilities and Shareholders' Equity  |   |                      |
| Current liabilities:  |   |                      |
| Current portion of long-term debt   | \$ 191                                  | \$ 202               |
| Current portion of capital lease related party  | -                                       | 81                   |
| Accounts payable  | 1,005                                   | 1,451                |
| Accrued employee compensation and benefit costs   | 1,634                                   | 1,434                |
| Other accrued liabilities   | 629                                     | 327                  |
| Total current liabilities   | 3,459                                   | 3,495                |
| Long-term debt  | 2,838                                   | 2,855                |
| Long-term portion of capital lease related party  | -                                       | 333                  |
| Deferred income taxes   | 496                                     | 496                  |
| Commitments and contingencies (see Note 10)   | -                                       | -                    |
| Shareholders' equity:   |   |                      |
| Common stock, par value \$.20; authorized 4,000,000 shares; issued 2,614,506 shares;<br>outstanding 2,144,316 (2,074,257 - 2011) shares | 523                                     | 523                  |
| Capital in excess of par value  | 13,926                                  | 13,774               |
| Retained earnings   | 12,034                                  | 12,490               |
| Accumulated other comprehensive loss  | (67 )                                   | (67 )                |
| Employee stock ownership trust commitment   | (1,266 )                                | (1,266 )             |
| Treasury stock, at cost 235,076 (305,135 - 2011) shares   | (1,717 )                                | (2,210 )             |
| Total shareholders' equity  | 23,433                                  | 23,244               |
| Total Liabilities and Shareholders' Equity  | \$30,226                                | \$ 30,423            |

See notes to consolidated financial statements

SERVOTRONICS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME (LOSS)

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

|   | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|---------|------------------------------------|----------|
|   | 2012                                | 2011    | 2012                               | 2011     |
| Revenue   | \$ 7,516                            | \$8,550 | \$23,302                           | \$24,592 |
| Costs, expenses and other income:   |                                     |         |                                    |          |
| Cost of goods sold, exclusive of depreciation and amortization              | 5,536                               | 5,821   | 17,081                             | 17,046   |
| Selling, general and administrative   | 1,275                               | 1,145   | 3,753                              | 3,543    |
| Interest expense  | 11                                  | 12      | 34                                 | 37       |
| Depreciation and amortization   | 141                                 | 139     | 437                                | 427      |
| Other income, net   | (2 )                                | (150 )  | (12 )                              | (164 )   |
| Total expenses  | 6,961                               | 6,967   | 21,293                             | 20,889   |
| Income from continuing operations before income tax provision               | 555                                 | 1,583   | 2,009                              | 3,703    |
| Income tax provision  | 249                                 | 476     | 663                                | 1,115    |
| Income from continuing operations   | 306                                 | 1,107   | 1,346                              | 2,588    |
| Discontinued Operations:  |                                     |         |                                    |          |
| Loss from operations of a discontinued component, net of income tax benefit | (188 )                              | (203 )  | (591 )                             | (550 )   |
| Loss on disposal of QCC and AMP, net of income tax benefit                  | (262 )                              | -       | (530 )                             | -        |
| Loss from discontinued operations   | (450 )                              | (203 )  | (1,121 )                           | (550 )   |
| Net income (loss)   | (\$144 )                            | \$904   | \$225                              | \$2,038  |
| Income (loss) per share:  |                                     |         |                                    |          |
| Basic   |                                     |         |                                    |          |
| Income per share from continuing operations                                 | \$ 0.14                             | \$0.56  | \$0.63                             | \$1.31   |
| Loss per share from discontinued operations                                 | (0.21 )                             | (0.10 ) | (0.53 )                            | (0.28 )  |
| Total net income (loss) per share   | (\$0.07 )                           | \$0.46  | \$0.10                             | \$1.03   |
| Diluted   |                                     |         |                                    |          |
| Income per share from continuing operations                                 | \$ 0.14                             | \$0.53  | \$0.63                             | \$1.23   |
| Loss per share from discontinued operations                                 | (0.21 )                             | (0.10 ) | (0.52 )                            | (0.26 )  |
| Total net income (loss) per share   | (\$0.07 )                           | \$0.43  | \$0.11                             | \$0.97   |

See notes to consolidated financial statements

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

|                                   | Three Months Ended |         | Nine Months Ended |         |
|-----------------------------------|--------------------|---------|-------------------|---------|
|                                   | September 30,      |         | September 30,     |         |
|                                   | 2012               | 2011    | 2012              | 2011    |
| Net income (loss)                 | \$(144             | ) \$904 | \$225             | \$2,038 |
| Other comprehensive income:       |                    |         |                   |         |
| Retirement benefits adjustment    | -                  | -       | -                 | -       |
| Total comprehensive income (loss) | \$(144             | ) \$904 | \$225             | \$2,038 |

See notes to consolidated financial statements

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

|   | Nine Months Ended<br>September 30, |          |
|---|------------------------------------|----------|
|   | 2012                               | 2011     |
| Cash flows related to operating activities:   |                                    |          |
| Net income  | \$225                              | \$2,038  |
| Adjustments to reconcile net income to net cash generated by operating activities - |                                    |          |
| Depreciation and amortization   | 484                                | 498      |
| Loss on disposal of QCC and AMP, net of income tax benefit                          | 530                                | -        |
| Increase in inventory reserve   | 59                                 | 52       |
| Increase in allowance for doubtful accounts   | 33                                 | 3        |
| Gain on disposal of property and equipment  | (9                                 | ) -      |
| Change in assets and liabilities:   |                                    |          |
| Accounts receivable   | 636                                | (455     |
| Inventories   | (1,106                             | ) (757   |
| Prepaid income taxes  | 101                                | 382      |
| Other assets  | (222                               | ) (117   |
| Other non-current assets  | (24                                | ) (29    |
| Accounts payable  | (446                               | ) 38     |
| Accrued employee compensation and benefit costs                                     | 196                                | 179      |
| Other accrued liabilities   | 152                                | 111      |
| Accrued income taxes  | -                                  | 7        |
| Net cash generated in operating activities  | 609                                | 1,950    |
| Cash flows related to investing activities:   |                                    |          |
| Capital expenditures - property, plant and equipment                                | (394                               | ) (435   |
| Proceeds from the sale of Queen Cutlery   | 640                                | -        |
| Net cash generated (used) in investing activities                                   | 246                                | (435     |
| Cash flows related to financing activities:   |                                    |          |
| Principal payments on long-term debt  | (29                                | ) (115   |
| Proceeds from exercise of stock options   | 234                                | -        |
| Principal payments on capital lease related party                                   | (41                                | ) (60    |
| Purchase of treasury shares   | (62                                | ) -      |
| Cash dividend   | (358                               | ) (336   |
| Purchase of stock options   | -                                  | (517     |
| Net cash used in financing activities   | (256                               | ) (1,028 |
| Net increase in cash and cash equivalents   | 599                                | 487      |
| Cash and cash equivalents at beginning of period                                    | 4,948                              | 4,447    |
| Cash and cash equivalents at end of period  | \$5,547                            | \$4,934  |

See notes to consolidated financial statements



SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by United States generally accepted accounting principles for complete financial statements.

The accompanying consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. All such adjustments are of a normal recurring nature. Operating results for the three and nine months ended September 30, 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 \$134,000 at September 30, 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 \$574,000 and \$773,000 at September 30, 2012 and December 31, 2011, respectively. Pre-production and start-up costs are expensed as incurred.

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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 assets and liabilities 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, combined New York and Texas state income tax returns and separate Pennsylvania and Arkansas state income tax returns.

The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company did not have any accrued interest or penalties included in its consolidated balance sheets at September 30, 2012 or December 31, 2011, and did not recognize any interest and/or penalties in its consolidated statements of income during the three and nine months ended September 30, 2012 and 2011.

Supplemental Cash Flow Information

Income taxes paid during the three months ended September 30, 2012 and 2011 amounted to zero and approximately \$291,000, respectively, and amounted to approximately \$256,000 and \$517,000 for the nine months ended September 30, 2012 and 2011 respectively. Interest paid during the three months ended September 30, 2012 and 2011 amounted to approximately \$12,000 and \$14,000, respectively, and amounted to \$38,000 and \$44,000 for the nine months ended September 30, 2012 and 2011, respectively. During the three and nine months ended September 30, 2012, the Company reduced its tax liability by approximately \$152,000 related to the exercise of stock options and was credited directly to capital in excess of par value.



SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Employee Stock Ownership Plan

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

Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in business circumstances indicate, 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 September 30, 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 12, Business Segments, for disclosures related to customer concentrations.

Fair Value of Financial Instruments

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



SERVOTRONICS, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 (loss) must be reclassified to net income (loss). 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 (loss) in the consolidated financial statements. For the three and nine month periods ended September 30, 2012 and 2011, there were no items affecting comprehensive income (loss).

3. Discontinued Operations

As previously reported, during the second quarter of 2012, the Company committed to a plan to enhance profit margins through the expected sale of a component. On September 18, 2012, Queen Cutlery Company (QCC), a wholly owned subsidiary of Servotronics Inc., completed the disposition of substantially all of its assets for cash consideration of \$650,000, less \$10,000 in escrow. QCC is accounted for as a discontinued operation in the accompanying consolidated financial statements. During the three and nine months ended September 30, 2012, QCC reported a loss on disposal related to a write-down of certain assets to lower of cost or market resulting in a before tax loss of approximately zero and \$406,000, respectively.

On July 23, 2013, Aero Metal Products, Inc. ("AMP"), a wholly owned subsidiary of Servotronics, Inc., gave notice of termination of a personal property capital lease for machinery and equipment previously reported under a \$588,000 capital lease with a related party. Due to the termination, beginning in July 2012, this lease is accounted for as an operating lease rather than a capital lease for the remaining term and the related assets and liabilities were removed from the consolidated balance sheet. In the third quarter of 2012, AMP ceased all manufacturing operations. As such, AMP is accounted for as discontinued operations in the accompanying consolidated financial statements and the Company accrued for the remaining balance payable on the personal property lease of \$67,500 in the accompanying September 30, 2012 financial statements. On October 23, 2012, AMP announced that it will surrender all assets under the personal property and real property lease to the lessor, Aero Inc., a previously reported related party, by November 3, 2012, which is the expiration date of the operating lease for the building. During the three and nine months ended September 30, 2012, AMP recorded a loss on disposal amounting to a before tax loss of approximately \$397,000 relating to a write-down of certain assets to lower of cost or market, accrual of remaining balance on operating leases, and expected costs to surrender assets.

The following is a summary of discontinued operations:

|                                     | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                     | 2012                                | 2011      | 2012                               | 2011      |
| Discontinued Operations:            | (\$000's omitted)                   |           |                                    |           |
| Revenue of QCC and AMP              | \$ 221                              | \$ 256    | \$ 899                             | \$ 901    |
| Loss from operations of QCC and AMP | (\$ 285 )                           | (\$ 291 ) | (\$ 895 )                          | (\$ 790 ) |

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|   |           |           |             |           |
|---|-----------|-----------|-------------|-----------|
| Income tax benefit                      | 97        | 88        | 304         | 240       |
| Net loss from operations of QCC and AMP | (188 )    | (203 )    | (591 )      | (550 )    |
| Loss on disposal of QCC and AMP         | (397 )    | -         | (804 )      | -         |
| Income tax benefit                      | 135       | -         | 274         | -         |
| Net loss from disposal of QCC and AMP   | (262 )    | -         | (530 )      | -         |
| Loss from discontinued operation        | (\$ 450 ) | (\$ 203 ) | (\$ 1,121 ) | (\$ 550 ) |

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SERVOTRONICS, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| 4.                                | Inventories              |                         |
|-----------------------------------|--------------------------|-------------------------|
|                                   | September<br>30,<br>2012 | December<br>31,<br>2011 |
|                                   | (\$000's omitted)        |                         |
| Raw materials and common parts    | \$ 5,917                 | \$ 5,727                |
| Work-in-process                   | 3,173                    | 3,511                   |
| Finished goods                    | 2,316                    | 2,369                   |
| Total inventories, net of reserve | \$ 11,406                | \$ 11,607               |

  

| 5.   | Property, Plant and Equipment |                         |
|--|-------------------------------|-------------------------|
|  | September<br>30,<br>2012      | December<br>31,<br>2011 |
|  | (\$000's omitted)             |                         |
| Land   | \$ 21                         | \$ 25                   |
| Buildings  | 7,021                         | 7,181                   |
| Machinery, equipment and tooling (including capital lease) | 12,116                        | 12,930                  |
|  | 19,158                        | 20,136                  |
| Less accumulated depreciation and amortization             | (13,544 )                     | (14,033 )               |
| Total property, plant and equipment                        | \$ 5,614                      | \$ 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 September 30, 2012 and December 31, 2011, accumulated amortization on the building amounted to approximately \$2,520,000 and \$2,423,000, respectively. Amortization expense amounted to \$32,000 for the three month periods ended September 30, 2012 and 2011, respectively and amounted to \$97,000 for the nine month periods ended September 30, 2012 and 2011, respectively. The associated current and long-term liabilities are discussed in Note 6, Long-Term Debt, of the accompanying consolidated financial statements.

On July 23, 2012, the Company gave notice of termination of a capital lease for machinery and equipment previously reported under a \$588,000 capital lease with a related party. Due to the termination, beginning in July 2012, this lease is accounted for as an operating lease rather than a capital lease for the remaining term and the related assets and liabilities were removed from the consolidated balance sheet. See also, Note 7, Capital Lease – Related Party, of the accompanying consolidated financial statements for more information. Amortization expense related to the capital lease related party, included in the loss from operations of a discontinued component, net of tax, amounted to zero and approximately \$21,000 for the three month periods ended September 30, 2012 and 2011, respectively, and \$42,000 and \$63,000 for the nine month periods ended September 30, 2012 and 2011, respectively.

Depreciation expense from continuing operations amounted to \$107,000 and \$106,000 for the three month periods ended September 30, 2012 and 2011, respectively, and amounted to \$334,000 and \$323,000 for the nine month periods ended September 30, 2012 and 2011, respectively. The combined depreciation and amortization expense from continuing operations amounted to \$141,000 and \$139,000 for the three month periods ended September 30, 2012 and 2011, respectively, and amounted to \$437,000 and \$427,000 for the nine month periods ended September

30, 2012 and 2011, respectively.

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SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| 6.  | Long-Term Debt | September 30,<br>2012 | December 31,<br>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 (0.43% at September 30, 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                           |                | 69                    | 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             |                | -                     | 11                   |
|   |                | 3,029                 | 3,057                |
| Less current portion  |                | (191 )                | (202 )               |
|   |                | \$ 2,838              | \$ 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.

During the nine months ended September 30, 2012, the Company increased the amount available on the unsecured line of credit from \$1,000,000 to \$2,000,000. There was no balance outstanding at September 30, 2012 and December 31, 2011. The line of credit is available through June of 2013.

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, 2012 and December 31, 2011, the Company was in compliance with its debt covenants.

## 7. 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 at AMP. On July 23, 2012, the Company gave notice of termination of the lease and as a result of the termination, beginning in July 2012, this lease is accounted for as an operating lease rather than a capital lease for the remaining term and the related assets and liabilities were removed from the consolidated balance sheet. There is no material gain or loss associated with the cancellation of such agreement. Under the terms of the Agreement, monthly payments of \$7,500 still continue through July 2013. The Company has accrued for the remaining balance payable of \$67,500 in the September 30, 2012 financial statements as a result of the discontinued operation discussed in Note 3. There are no other future obligations under this lease.



SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 8. Income Taxes

The Company did not have any material uncertain tax positions or unrecognized tax benefits or obligations as of September 30, 2012 and December 31, 2011.

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 2009 through 2011 federal and state tax returns remain open under statute.

## 9. Shareholders' Equity

|   | (\$000's omitted)<br>Common Stock |        | Capital in<br>excess of<br>par value | Retained<br>earnings | ESOP        | Accumulated       |                                | Total<br>Shareholders'<br>Equity |
|---|-----------------------------------|--------|--------------------------------------|----------------------|-------------|-------------------|--------------------------------|----------------------------------|
|   | Number<br>of shares<br>issued     | Amount |                                      |                      |             | Treasury<br>Stock | Other<br>Comprehensive<br>Loss |                                  |
| Balance<br>December 31,<br>2011                               | 2,614,506                         | \$ 523 | \$ 13,774                            | \$ 12,490            | (\$ 1,266 ) | (\$ 2,210 )       | (\$ 67 )                       | \$ 23,244                        |
| Net income  | -                                 | -      | -                                    | 225                  | -           | -                 | -                              | 225                              |
| Cash<br>dividend  | -                                 | -      | -                                    | (358 )               | -           | -                 | -                              | (358 )                           |
| Purchase of<br>treasury shares                                | -                                 | -      | -                                    | -                    | -           | (62 )             | -                              | (62 )                            |
| Exercise of<br>stock options,<br>net of income<br>tax benefit | -                                 | -      | 152                                  | (323 )               | -           | 555               | -                              | 384                              |
| Balance<br>September 30,<br>2012                              | 2,614,506                         | \$ 523 | \$ 13,926                            | \$ 12,034            | (\$ 1,266 ) | (\$ 1,717 )       | (\$ 67 )                       | \$ 23,433                        |

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 September 30, 2012, the Company has purchased 245,529 shares and there remain 204,471 shares available to purchase under this program. There were 7,441 and zero shares purchased by the Company during the nine month periods ended September 30, 2012 and 2011, respectively.

In the second quarter of 2012 certain option holders, including the independent directors, Chief Executive Officer and the Chief Operating Officer, elected to exercise 71,000 options, of which 2,500 were bought back by the Company resulting in 68,500 net shares issued out of treasury stock for net proceeds of approximately \$215,000. Such transactions were properly reported on Form 4 with the Securities and Exchange Commission. A tax benefit to the

Company of approximately \$152,000 associated with these transactions reduced taxes payable and was credited directly to capital in excess of par value. Also in the first quarter of 2012, one option holder elected to exercise 9,000 options, resulting in 9,000 shares issued out of treasury stock for proceeds of approximately \$18,000.

On May 14, 2012 the Company announced that its Board of Directors declared a \$0.15 per share cash dividend. The dividend was subsequently paid on July 2, 2012 to shareholders of record on June 1, 2012 and was approximately \$358,000 in the aggregate. These dividends do not represent that the Company will pay dividends on a regular or scheduled basis. The amount is recorded in dividends payable on the accompanying consolidated balance sheet.

SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

|   | Three Months Ended<br>September 30,     |          | Nine Months Ended<br>September 30, |          |
|---|---|----------|------------------------------------|----------|
|   | 2012                                    | 2011     | 2012                               | 2011     |
|   | (\$000's omitted except per share data) |          |                                    |          |
| Income from continuing operations                               | \$ 306                                  | \$ 1,107 | \$ 1,346                           | \$ 2,588 |
| Loss from discontinued operations                               | (450 )                                  | (203 )   | (1,121 )                           | (550 )   |
| Net income (loss)   | (\$ 144 )                               | \$ 904   | \$ 225                             | \$ 2,038 |
| Weighted average common shares<br>outstanding (basic)           | 2,146                                   | 1,982    | 2,125                              | 1,982    |
| Incremental shares from assumed<br>conversions of stock options | 6                                       | 89       | 19                                 | 117      |
| Weighted average common shares<br>outstanding (diluted)         | 2,152                                   | 2,071    | 2,144                              | 2,099    |
| <b>Basic</b>  |   |          |                                    |          |
| Income per share from continuing<br>operations                  | \$ 0.14                                 | \$ 0.56  | \$ 0.63                            | \$ 1.31  |
| Loss per share from discontinued<br>operations                  | (0.21 )                                 | (0.10 )  | (0.53 )                            | (0.28 )  |
| Total net income (loss) per share                               | (\$ 0.07 )                              | \$ 0.46  | \$ 0.10                            | \$ 1.03  |
| <b>Diluted</b>  |   |          |                                    |          |
| Income per share from continuing<br>operations                  | \$ 0.14                                 | \$ 0.53  | \$ 0.63                            | \$ 1.23  |
| Loss per share from discontinued<br>operations                  | (0.21 )                                 | (0.10 )  | (0.52 )                            | (0.26 )  |
| Total net income (loss) per share                               | (\$ 0.07 )                              | \$ 0.43  | \$ 0.11                            | \$ 0.97  |

10.

Commitments and Contingencies

The Company has a probable contingent liability related to the termination of an employment agreement for an Executive Officer of the Company, effective September 29, 2012. The Company is unable to reasonably or accurately estimate the amount of the liability at this time. Under the terms of the agreement, management estimates that the compensation in the form of future medical benefits and severance payments could result in additional liabilities as high as approximately \$1,400,000. However, the Company is disputing these amounts and is currently in negotiation with the former officer to settle the potential liability. Accordingly, no additional liability has been accrued as of September 30, 2012 related to this item.

The Company leases certain equipment and real property pursuant to operating lease arrangements. Total rental expense in the three and nine month periods ended September 30, 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 5, Property, Plant and Equipment, Note 6, Long-Term Debt, Note 7, Capital Lease – Related Party and Note 11, Related Party Transactions of the accompanying consolidated financial statements for information on the leases.

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SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. 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. As previously reported, on July 23, 2012, the Company gave notice of termination of the Personal Property Lease dated as of November 3, 2009 (the "Agreement"). Under the terms of the Agreement, monthly payments of \$7,500 still continue to July 2013. The Company has accrued for the remaining balance payable of \$67,500 in the accompanying September 30, 2012 financial statements. See Note 7, Capital Lease-Related Party, of the accompanying consolidated financial statements. The Company also entered into a real property operating lease agreement, with the same related party, which provided for annual rental of \$60,000. The term of the real property lease ended on November 3, 2012 and AMP has surrendered the property by such date. There are no other future obligations under these leases.

12. 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 sale of QCC and the closure of AMP are not expected to have a material impact on either government or commercial sales. The result of these discontinued operations eliminates primarily gentlemen folding blades and various shears to the CPG product lines. The Company derives its primary sales revenue from domestic customers, although a portion of finished products are for foreign end use.

As of September 30, 2012, the Company had identifiable assets of approximately \$30,226,000 (\$30,423,000 – December 31, 2011) of which approximately \$19,919,000 (\$18,004,000 – December 31, 2011) was for ATG and approximately \$10,307,000 (\$12,419,000 – December 31, 2011) was for CPG.

SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

|   | ATG                                |           | CPG                                |          | Consolidated                       |           |
|---|------------------------------------|-----------|------------------------------------|----------|------------------------------------|-----------|
|   | Nine Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|   | 2012                               | 2011      | 2012                               | 2011     | 2012                               | 2011      |
| Revenues from unaffiliated customers  | \$16,671                           | \$15,817  | \$ 6,631                           | \$8,775  | \$23,302                           | \$24,592  |
| Cost of goods sold, exclusive of depreciation and amortization              | (11,445 )                          | (10,571 ) | (5,636 )                           | (6,475 ) | (17,081 )                          | (17,046 ) |
| Selling, general and administrative   | (2,411 )                           | (2,201 )  | (1,342 )                           | (1,342 ) | (3,753 )                           | (3,543 )  |
| Interest expense  | (34 )                              | (37 )     | -                                  | -        | (34 )                              | (37 )     |
| Depreciation and amortization   | (323 )                             | (319 )    | (114 )                             | (108 )   | (437 )                             | (427 )    |
| Other income, net   | 5                                  | 153       | 7                                  | 11       | 12                                 | 164       |
| Income (loss) from continuing operations before income tax provision        | 2,463                              | 2,842     | (454 )                             | 861      | 2,009                              | 3,703     |
| Income tax provision (benefit)  | 812                                | 855       | (149 )                             | 260      | 663                                | 1,115     |
| Income (loss) from continuing operations                                    | 1,651                              | 1,987     | (305 )                             | 601      | 1,346                              | 2,588     |
| Discontinued Operations:  |                                    |           |                                    |          |                                    |           |
| Loss from operations of a discontinued component, net of income tax benefit | -                                  | -         | (591 )                             | (550 )   | (591 )                             | (550 )    |
| Loss on disposal of QCC and AMP, net of income tax benefit                  | -                                  | -         | (530 )                             | -        | (530 )                             | -         |
| Loss from discontinued operations   | -                                  | -         | (1,121 )                           | (550 )   | (1,121 )                           | (550 )    |
| Net income (loss)   | \$1,651                            | \$1,987   | (\$1,426 )                         | \$51     | \$225                              | \$2,038   |
| Capital expenditures  | \$327                              | \$151     | \$ 67                              | \$284    | \$394                              | \$435     |

SERVOTRONICS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

|   | ATG                |          | CPG                |          | Consolidated       |          |
|---|--------------------|----------|--------------------|----------|--------------------|----------|
|   | Three Months Ended |          | Three Months Ended |          | Three Months Ended |          |
|   | September 30,      |          | September 30,      |          | September 30,      |          |
|   | 2012               | 2011     | 2012               | 2011     | 2012               | 2011     |
| Revenues from unaffiliated customers  | \$5,783            | \$5,409  | \$1,733            | \$3,141  | \$7,516            | \$8,550  |
| Cost of goods sold, exclusive of depreciation and amortization              | (4,080 )           | (3,522 ) | (1,456 )           | (2,299 ) | (5,536 )           | (5,821 ) |
| Selling, general and administrative   | (842 )             | (704 )   | (433 )             | (441 )   | (1,275 )           | (1,145 ) |
| Interest expense  | (11 )              | (12 )    | -                  | -        | (11 )              | (12 )    |
| Depreciation and amortization   | (104 )             | (105 )   | (37 )              | (34 )    | (141 )             | (139 )   |
| Other income, net   | -                  | 145      | 2                  | 5        | 2                  | 150      |
| Income (loss) from continuing operations before income tax provision        | 746                | 1,211    | (191 )             | 372      | 555                | 1,583    |
| Income tax provision (benefit)  | 335                | 365      | (86 )              | 111      | 249                | 476      |
| Income (loss) from continuing operations                                    | 411                | 846      | (105 )             | 261      | 306                | 1,107    |
| Discontinued Operations:  |                    |          |                    |          |                    |          |
| Loss from operations of a discontinued component, net of income tax benefit | -                  | -        | (188 )             | (203 )   | (188 )             | (203 )   |
| Loss on disposal of QCC and AMP, net of income tax benefit                  | -                  | -        | (262 )             | -        | (262 )             | -        |
| Loss from discontinued operations   | -                  | -        | (450 )             | (203 )   | (450 )             | (203 )   |
| Net income (loss)   | \$411              | \$846    | \$(555 )           | \$58     | \$(144 )           | \$904    |
| Capital expenditures  | \$234              | \$70     | \$24               | \$180    | \$258              | \$250    |

13. Other Income

Components of other income include interest income on cash and cash equivalents, and other amounts not directly related to the sale of the Company's products. Other income is immaterial in relationship to the consolidated financial statements.

14. Subsequent Events

In October 2012, Servotronics, Inc. entered into an agreement with a local contractor for the construction of a new 30 x 36 foot testing facility that will be located in Elma, New York. The facility expansion is in response to an increase in demand and is expected to cost up to \$700,000, including related equipment. The expansion is expected to be funded from operating cash flows and the target completion date is in the first quarter of 2013.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Management Discussion

During the three months ended September 30, 2012 and 2011 approximately 26% and 43%, respectively, and 31% and 42% for the nine months ended September 30, 2012 and 2011, respectively, of the Company's revenues from continuing operations were derived from contracts with agencies of the U.S. Government or their prime contractors and their subcontractors. Sales of products sold for government applications decreased when comparing the results of the three and nine months ended September 30, 2012 to September 30, 2011, due to decreased government shipments at the Consumer Products Group in the amount of approximately \$1,716,000 and \$3,141,000, respectively, while shipments to the government at the Advanced Technology Group remained consistent. The Company believes that government involvement in military operations overseas will continue to have an impact on the financial results for both the ATG's and CPG's markets. While the Company is optimistic in relation to these potential 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 ATG continues its aggressive business development efforts in its primary markets and is broadening its activities to include new domestic and foreign markets that are consistent with its core competencies. There are substantial uncertainties in the current global economy which in turn may affect the Company's sales revenues from period to period in 2012 and beyond. Although the ATG backlog continues to be strong, actual scheduled shipments may be delayed/changed as a function of the Company's customers' final delivery determinations that are based on changes in the global economy and other factors.

The Company's CPG develops new commercial products and products for government and military applications. Included in the significant uncertainties in the near and long term are the effects of the U. S. and world stimulus plans and the difficulty to accurately project the net effect of the vagaries inherent in the government procurement process and programs notwithstanding that the U.S government may not process or otherwise delay subject procurements. The ATG and CPG continue to respond to U.S. government procurement requests for quotes. New product development activities are ongoing along with the acquisition and development of new product lines. The sale of QCC and the closure of AMP are not expected to have a material impact on either government or commercial sales. The result of these discontinued operations eliminates primarily gentleman folding blades and various shears to the CPG product lines.

## Results of Operations

The following table compares the Company's consolidated statements of income data for the nine and three months ended September 30, 2012 and 2011 (\$000's omitted).

|   | Nine Months Ended September 30, |            |          |            | 2012 vs. 2011 |            |
|---|---------------------------------|------------|----------|------------|---------------|------------|
|   | 2012                            |            | 2011     |            | Dollar        | % Increase |
|   | Dollars                         | % of Sales | Dollars  | % of Sales | Change        | (Decrease) |
| Revenue:  |                                 |            |          |            |               |            |
| Advanced Technology   | \$16,671                        | 71.5%      | \$15,817 | 64.3%      | \$854         | 5.4%       |
| Consumer Products   | 6,631                           | 28.5%      | 8,775    | 35.7%      | (2,144)       | (24.4%)    |
|   | 23,302                          | 100.0%     | 24,592   | 100.0%     | (1,290)       | (5.2%)     |
| Cost of goods sold, exclusive of depreciation and amortization              | 17,081                          | 73.3%      | 17,046   | 69.3%      | 35            | 0.2%       |
| Selling, general and administrative   | 3,753                           | 16.1%      | 3,543    | 14.4%      | 210           | 5.9%       |
| Depreciation and amortization   | 437                             | 1.9%       | 427      | 1.7%       | 10            | 2.3%       |
| Total costs and expenses  | 21,271                          | 91.3%      | 21,016   | 85.4%      | 255           | 1.2%       |
| Operating income, net   | 2,031                           | 8.7%       | 3,576    | 14.6%      | (1,545)       | (43.2%)    |
| Interest expense  | 34                              | 0.1%       | 37       | 0.2%       | (3)           | (8.1%)     |
| Other income, net   | (12)                            | (0.1%)     | (164)    | (0.7%)     | 152           | (92.7%)    |
| Income tax provision  | 663                             | 2.8%       | 1,115    | 4.5%       | (452)         | (40.5%)    |
| Income from continuing operations   | 1,346                           | 5.9%       | 2,588    | 10.6%      | (1,242)       | (48.0%)    |
| Discontinued Operations:  |                                 |            |          |            |               |            |
| Loss from operations of a discontinued component, net of income tax benefit | (591)                           | (2.5%)     | (550)    | (2.2%)     | (41)          | 7.5%       |
| Loss on disposal of QCC and AMP, net of income tax benefit                  | (530)                           | (2.3%)     | -        | 0.0%       | (530)         | 100.0%     |
| Loss from discontinued operations   | (1,121)                         | (4.8%)     | (550)    | (2.2%)     | (571)         | 103.8%     |
| Net income  | \$225                           | 1.1%       | \$2,038  | 8.4%       | \$(1,813)     | (89.0%)    |

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|   | Three Months Ended September 30, |            |                 |            | 2012 vs. 2011    |                          |
|---|----------------------------------|------------|-----------------|------------|------------------|--------------------------|
|   | 2012<br>Dollars                  | % of Sales | 2011<br>Dollars | % of Sales | Dollar<br>Change | % Increase<br>(Decrease) |
| <b>Revenue:</b>   |                                  |            |                 |            |                  |                          |
| Advanced Technology   | \$ 5,783                         | 76.9%      | \$ 5,409        | 63.3%      | \$ 374           | 6.9%                     |
| Consumer Products   | 1,733                            | 23.1%      | 3,141           | 36.7%      | (1,408)          | (44.8%)                  |
|   | 7,516                            | 100.0%     | 8,550           | 100.0%     | (1,034)          | (12.1%)                  |
| <b>Cost of goods sold, exclusive of depreciation and amortization</b>       |                                  |            |                 |            |                  |                          |
| Selling, general and administrative   | 5,536                            | 73.7%      | 5,821           | 68.1%      | (285)            | (4.9%)                   |
| Depreciation and amortization   | 1,275                            | 17.0%      | 1,145           | 13.4%      | 130              | 11.4%                    |
| Total costs and expenses  | 141                              | 1.9%       | 139             | 1.6%       | 2                | 1.4%                     |
| Operating income, net   | 6,952                            | 92.6%      | 7,105           | 83.1%      | (153)            | (2.2%)                   |
| Interest expense  | 564                              | 7.4%       | 1,445           | 16.9%      | (881)            | (61.0%)                  |
| Other income, net   | 11                               | 0.1%       | 12              | 0.1%       | (1)              | (8.3%)                   |
| Income tax provision  | (2)                              | 0.0%       | (150)           | (1.8%)     | 148              | (98.7%)                  |
| Income from continuing operations   | 249                              | 3.3%       | 476             | 5.6%       | (227)            | (47.7%)                  |
| Discontinued Operations:  | 306                              | 4.0%       | 1,107           | 13.0%      | (801 )           | (72.4%)                  |
| Loss from operations of a discontinued component, net of income tax benefit | (188)                            | (2.5%)     | (203)           | (2.4%)     | 15               | (7.4%)                   |
| Loss on disposal of QCC and AMP, net of income tax benefit                  | (262)                            | (3.5%)     | -               | 0.0%       | (262)            | 100.0%                   |
| Loss from discontinued operations   | (450)                            | (6.0%)     | (203)           | (2.4%)     | (247)            | 121.7%                   |
| Net income (loss)   | \$ (144)                         | (2.0%)     | \$ 904          | 10.6%      | \$ (1,048)       | (115.9%)                 |

Revenue

The Company's consolidated revenues for continuing operations decreased approximately \$1,034,000 or 12.1% for the three month period ended September 30, 2012 and \$1,290,000 or 5.2% for the nine month period ended September 30, 2012 when compared to the same three and nine month periods in 2011. The decrease is due to decreased shipments at the Consumer Products Group (CPG) mainly due to a decrease in shipments related to orders from the U.S. Government and its prime vendors. These decreases are not fully offset by increases in commercial shipments at the CPG and ATG. Procurements and timing of shipments under Government contracts at the CPG may, at times, significantly impact operating results from period to period.

Cost of Goods Sold

Cost of goods sold as a percentage of revenues increased for the three and nine month periods ended September 30, 2012 and 2011 due to a decrease in government sales at the CPG with disproportionate decreases in labor and overhead costs and additional costs at the ATG related to customer driven process improvement. These additional costs were approximately \$100,000 and were expensed in the third quarter of 2012. Also included in the third quarter of 2012 was approximately \$75,000 in retroactive pay adjustments for production employees. Fluctuation in cost of goods sold as a percentage of revenues also results from the mix of products sold in the period.

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### Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses as a percentage of revenue increased for the three and nine month periods ended September 30, 2012 as compared to the same period in 2011. Selling, general and administrative expenses are attributable to marketing of products (i.e., costs of internal and external sales efforts, catalog production, and the promotion of new and existing products in current and new markets). Also included in SG&A expenses are the labor and related costs for general and administrative support, accounting, professional, legal and information technology costs. The increase is primarily due to \$130,000 of additional costs in professional and legal expenses for the nine months ended September 30, 2012 as well as \$26,000 in retroactive pay adjustments for non-production employees during the third quarter of 2012.

### Interest Expense

Interest expense remained relatively consistent for the three and nine month periods ended September 30, 2012 compared to the same periods in 2011 due to interest rates which have remained consistent. See also Note 6, Long-Term Debt, of the accompanying consolidated financial statements for information on long-term debt.

### Depreciation and Amortization Expense

Depreciation and amortization expense remained relatively consistent for the three and nine month periods ended September 30, 2012 compared to the same periods in 2011. Depreciation expense fluctuates due to variable estimated useful lives of depreciable property (as identified in Note 2, Summary of Significant Accounting Policies, of the accompanying consolidated financial statements) as well as the amount and nature of capital expenditures in current and previous periods. It is anticipated that the Company's future capital expenditures will, at a minimum, follow the Company's requirements to support its manufacturing delivery commitments and to meet certain information technology related capital expenditure requirements.

### Other Income

Components of other income include interest income on cash and cash equivalents and other amounts not directly related to the sale of the Company's products. Other income is immaterial in relationship to the consolidated financial statements.

### Income Taxes

The Company's continuing operations effective tax rate was approximately 44.9% and 30.1% for the three month periods ended September 30, 2012 and 2011, respectively, and approximately 33% and 30.1% for the nine month periods ended September 30, 2012 and 2011, respectively and the discontinued operations effective tax rate was approximately 34.0% for the three and nine month periods ended September 30, 2012 and 30.1% for the same periods of 2011. The effective tax rates reflect the estimated annual effective rates for federal and state income taxes, permanent non-deductible expenditures and the expected tax benefit for manufacturing deductions allowable under the American Jobs Creation Act of 2004. See also Note 8, Income Taxes, of the accompanying consolidated financial statements for information concerning income tax.

### Income From Continuing Operations

Income from continuing operations for the three month period ended September 30, 2012 decreased \$801,000 or 72.4% when compared to the same period ended September 30, 2011. Income from continuing operations for the nine month period ended September 30, 2012 decreased \$1,242,000 or 48.0% when compared to the same period

ended September 30, 2011. The decrease in income from continuing operations is primarily the result of decreased revenues and shipments of products with lower margins at the Company's Consumer Products Group.

### Discontinued Operations

As previously reported, during the second quarter of 2012, the Company committed to a plan to enhance profit margins through the expected sale of a component. On September 18, 2012, Queen Cutlery Company (“QCC”), a wholly owned subsidiary of Servotronics Inc., completed the disposition of substantially all of its assets for cash consideration of \$650,000, less \$10,000 in escrow. QCC is accounted for as a discontinued operation in the accompanying consolidated financial statements. During the three and nine months ended September 30, 2012, QCC reported a loss on disposal related to a write-down of certain assets to lower of cost or market resulting in a before tax loss of approximately zero and \$406,000, respectively.

On July 23, 2013, Aero Metal Products, Inc. (“AMP”), a wholly owned subsidiary of Servotronics, Inc., gave notice of termination of a personal property capital lease for machinery and equipment previously reported under a \$588,000 capital lease with a related party. Due to the termination, beginning in July 2012, this lease is accounted for as an operating lease rather than a capital lease for the remaining term and the related assets and liabilities were removed from the consolidated balance sheet. In the third quarter of 2012, AMP ceased all manufacturing operations. As such, AMP is accounted for as discontinued operations in the accompanying consolidated financial statements and the Company accrued for the remaining balance payable on the personal property lease of \$67,500 in the accompanying September 30, 2012 financial statements. On October 23, 2012, AMP announced that it will surrender all assets under the personal property and real property lease to the lessor, Aero Inc., a previously reported related party, by November 3, 2012, which is the expiration date of the operating lease for the building. During the three and nine months ended September 30, 2012, AMP recorded a loss on disposal amounting to a before tax loss of approximately \$397,000 relating to a write-down of certain assets to lower of cost or market, accrual of remaining balance on operating leases, and expected costs to surrender assets.

### Liquidity and Capital Resources

The Company’s primary liquidity and capital requirements relate to working capital needs; primarily inventory and accounts receivable as well as capital expenditures for property, plant and equipment and principal and interest payments on debt. At September 30, 2012, the Company had working capital of approximately \$20,789,000 (\$20,483,000 – December 31, 2011) of which approximately \$5,547,000 (\$4,948,000– December 31, 2011) was comprised of cash and cash equivalents.

The Company generated approximately \$609,000 in cash from operations during the nine months ended September 30, 2012. Cash was generated primarily through net income, collection of receivables, an increase in accrued employee compensation and benefit costs as well as an increase to other accrued liabilities. The primary use of cash for the Company’s operating activities for the nine months ended September 30, 2012 include working capital requirements, mainly inventory, prepayments on insurances and property tax, other current assets and prepaid income taxes. Cash generated and used in operations is consistent with sales volume, customer expectations and competitive pressures. The Company’s primary use of cash in its financing and investing activities in the first nine months of 2012 included approximately \$358,000 for cash dividends paid on July 2, 2012. The Company also expended approximately \$394,000 for capital expenditures during the nine months ended September 30, 2012. These uses are partially offset by cash generated in the amount of \$640,000 for the sale of Queen Cutlery Company.

At September 30, 2012, there are no material commitments for capital expenditures; however, subsequent to September 30, 2012, the Company entered into an agreement with a local contractor for the construction of a new 30 x 36 foot testing facility that will be located in Elma, New York. It is expected to cost up to \$700,000 including related equipment and to be funded from operating cash flows. The Company also has an unsecured \$2,000,000 line of credit on which there is no balance outstanding at September 30, 2012. If needed, this can be used to fund cash flow requirements. The Company believes that it has adequate internal and external resources available to fund expected working capital and capital expenditure requirements through fiscal 2012 as supported by the level of cash/cash equivalents on hand, cash flow from operations and bank line of credit.

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 4. 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 defined in Exchange Act Rule 13a-15(e)) as of September 30, 2012. Based upon that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in SEC reports under the Exchange Act (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 nine month period ended September 30, 2012, there were no changes in internal controls over financial reporting that have materially affected, or are reasonably likely to affect, the Company's internal controls over financial reporting.

PART II  
OTHER INFORMATION

Item 1. Legal Proceedings

There are no legal proceedings which are material to the Company currently pending by or against the Company other than ordinary routine litigation incidental to the business which is not expected to materially adversely affect the business or earnings of the Company.

Item Risk Factors

1A.

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

## (c) Company Purchases of Company's Equity Securities

| 2012 Periods                | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that may yet be Purchased under the Plans or Programs |
|-----------------------------|----------------------------------|------------------------------|--|--|
| January 1– March 31, 2012   | -                                | -                            | -  | 211,912  |
| April 1 – June 30, 2012     | 2,765                            | 8.00                         | 2,765  | 209,147  |
| July 1 – September 30, 2012 | 4,676                            | 8.48                         | 4,676  | 204,471  |
| Total                       | 7,441                            | 8.30                         | 7,441  | 204,471  |

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 October 31, 2012, the Company has purchased 246,723 shares and there remain 203,277 shares available to purchase under this program.

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

None.

Item 6.

Exhibits

2.1 Asset Purchase Agreement as of September 18, 2012 by and between Daniels Family Cutlery Corporation and Queen Cutlery Company (incorporated by reference to Exhibit 2.1 to the Company's Form 8-K filed with the SEC on September 24, 2012)

2.2 Agreement for the Sale of Real Estate dated September 18, 2012 by and between Daniels Family Cutlery Corporation and Queen Cutlery Company (incorporated by reference to Exhibit 2.2 to the Company's Form 8-K filed with the SEC on September 24, 2012)

4.1 Servotronics, Inc. Shareholder Rights Plan dated as of October 15, 2012, which includes the form of Rights Certificate as Exhibit A, the Summary of Rights to Purchase Preferred Stock as Exhibit B, and the Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock as Exhibit C (incorporated by reference to Exhibit 4.1 to the Company's Form 8-K filed with the SEC on October 17, 2012)

10 Material Contracts (\*Indicates management contract or compensatory plan or arrangement)

10.1\* Servotronics, Inc. 2012 Long-Term Incentive Plan (incorporated by reference to Appendix A to the Company's proxy statement for the 2012 Annual meeting of Shareholders)

10.2\* Amendment to employment contract for Dr. Nicholas D. Trbovich dated August 13, 2012 (Filed herewith)

10.3\* Employment contract for Kenneth D. Trbovich dated June 15, 2012 (Filed herewith)

10.4\* Amendment to employment contract for Kenneth D. Trbovich dated August 13, 2012 (Filed herewith)

31.1 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 (Filed herewith)

31.2 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 (Filed herewith)

32.1 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 (Filed herewith)

32.2 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 (Filed herewith)

101 The following materials from Servotronics, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) consolidated balance sheets, (ii) consolidated statements of income, (iii) consolidated statements of comprehensive income, (iv) consolidated statements of cash flows and (v) the notes to the consolidated financial statements, tagged as block of text.\*\*

\*\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.





### 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.

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, 2012

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