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SERVOTRONICS INC /DE/
Form 10QSB
May 15, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
--- ACT OF 1934
For the quarterly period ended March 31, 2007

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 small business issuer as specified in its charter)

Delaware

16-0837866

(State or other jurisdiction of
incorporation or organization)

(IRS Employer
Identification No.)

1110 Maple Street, Elma, New York 14059-0300

(Address of principal executive offices)

716-655-5990

(Issuer's telephone number, including area code)

Check whether the issuer (1) filed all reports required to be filed by
Section 13 or 15(d) of the Exchange Act 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 X . No .
--- --

Indicate by check mark whether the registrant is a shell company (as defined in
Rule 12b-2 of the Exchange Act). Yes ; No X
--- --

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

| Class | Outstanding at April 30, 2007 |
|-------------------------------|-------------------------------|
| ----- | ----- |
| Common Stock, \$.20 par value | 1,957,734 |

Transitional Small Business Disclosure Format (Check one):

Yes ; No X
--- --

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

| | March 31, 2007 |
|------------------------------------|----------------|
| ----- | |
| ASSETS | |
| Current assets: | |
| Cash and cash equivalents | \$ 3,997 |
| Accounts receivable | 4,013 |
| Inventories | 7,262 |
| Deferred income taxes | 545 |
| Other assets | 720 |
| | ----- |
| Total current assets | 16,537 |
| Property, plant and equipment, net | 5,880 |
| Other non-current assets | 375 |

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| | |
|---|-----------|
| | ----- |
| | \$ 22,792 |
| | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | |
| Current liabilities: | |
| Current portion of long-term debt | \$ 384 |
| Accounts payable | 1,483 |
| Accrued employee compensation and benefit costs | 1,254 |
| Accrued income taxes | 16 |
| Other accrued liabilities | 215 |
| | ----- |
| Total current liabilities | 3,352 |
| Long-term debt | 4,577 |
| Deferred income taxes | 515 |
| Shareholders' equity: | |
| Common stock, par value \$.20; authorized 4,000,000 shares; issued 2,614,506 shares; outstanding 1,957,734 shares | 523 |
| Capital in excess of par value | 13,033 |
| Retained earnings | 4,906 |
| Accumulated other comprehensive loss | (278) |
| | ----- |
| Employee stock ownership trust commitment | 18,184 |
| Treasury stock, at cost 285,404 shares | (1,933) |
| | ----- |
| Total shareholders' equity | 14,348 |
| | ----- |
| | \$ 22,792 |
| | ===== |

See notes to consolidated financial statements

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

| | |
|---|--------------|
| | Three Months |
| | March 3 |
| | 2007 |
| | ----- |
| Revenues | \$ 6,530 |
| Costs, expenses: | |
| Cost of goods sold, exclusive of depreciation | 5,117 |
| Selling, general and administrative | 911 |
| Interest | 62 |
| Depreciation and amortization | 139 |
| Other income, net | (34) |
| | ----- |

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| | |
|------------------------------------|---------|
| | 6,195 |
| | ----- |
| Income before income tax provision | 335 |
| Income tax provision | 131 |
| | ----- |
| Net income | \$ 204 |
| | ===== |
| | |
| Income per share: | |
| BASIC | |
| Net income per share | \$ 0.10 |
| | ===== |
| DILUTED | |
| Net income per share | \$ 0.10 |
| | ===== |

See notes to consolidated financial statements

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

| | |
|--|--------------|
| | Three Months |
| | March |
| | 2007 |
| | ----- |
| CASH FLOWS RELATED TO OPERATING ACTIVITIES: | |
| Net income | \$ 204 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities - | |
| Depreciation and amortization | 139 |
| Change in assets and liabilities - | |
| Accounts receivable | 213 |
| Inventories | (401) |
| Other assets | (157) |
| Other non-current assets | 24 |
| Accounts payable | 278 |
| Accrued employee compensation and benefit costs | 165 |
| Other accrued liabilities | (105) |
| Accrued income taxes | (31) |
| | ----- |
| Net cash provided by (used in) operating activities | 329 |
| | ----- |
| CASH FLOWS RELATED TO INVESTING ACTIVITIES: | |
| Capital expenditures - property, plant and equipment | (79) |
| | ----- |
| Net cash used in investing activities | (79) |
| | ----- |

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| | |
|--|----------|
| CASH FLOWS RELATED TO FINANCING ACTIVITIES: | |
| Principal payments on long-term debt | (54) |
| Purchase of treasury shares | (303) |
| | ----- |
| Net cash used in financing activities | (357) |
| | ----- |
| Net decrease in cash and cash equivalents | (107) |
| Cash and cash equivalents at beginning of period | 4,104 |
| | ----- |
| Cash and cash equivalents at end of period | \$ 3,997 |
| | ===== |

See notes to consolidated financial statements

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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-QSB and Item 310 of Regulation S-B. 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 months ending March 31, 2007 are not necessarily indicative of the results that may be expected for the year ended December 31, 2007. 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"). All intercompany accounts and transactions have been eliminated in 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.

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

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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 cost incurred to bring each product to its present location and condition, which approximates actual cost (first-in, first-out). Market provisions in respect of net realizable value and obsolescence are applied to the gross value of the inventory. 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 in income.

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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 and separate state income tax returns.

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

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disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal. The Company has determined that no impairment of long-lived assets existed at March 31, 2007 and 2006.

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."

RECLASSIFICATIONS

Certain balances as of March 31, 2006 were reclassified to conform with classifications adopted in the current year.

NEW ACCOUNTING PRONOUNCEMENTS

In June 2006, the FASB issued Interpretation No. 48 "Accounting for Uncertainty in Income Taxes", an interpretation of SFAS109 "Accounting for Income Taxes" (FIN 48), to create a single model to address accounting for uncertain tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company has adopted FIN 48 as of January 1, 2007, as required. The cumulative effect of adopting FIN 48

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is recorded in retained earnings. The adoption of FIN 48 did not have a material impact on the Company's financial position and results of operations. See Note 7 to the 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-a-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

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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 accounts in financial institutions. Although the accounts exceed the federally insured deposit amount, management does not anticipate nonperformance by the financial institutions.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount of cash and cash equivalents, accounts receivable, inventories, 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, the fair value approximates its carrying amount.

3. INVENTORIES

| | March 31, 2007 |
|---|-------------------|
| | ----- |
| | (\$000's omitted) |
| Raw materials and common parts | \$ 2,642 |
| Work-in-process | 3,677 |
| Finished goods | 1,073 |
| | ----- |
| | 7,392 |
| Less common parts expected to be used after one year (classified as long-term) | (130) |
| | ----- |
| | \$ 7,262 |
| | ===== |

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4. PROPERTY, PLANT AND EQUIPMENT

| | March 31, 2007 |
|--|-------------------|
| | ----- |
| | (\$000's omitted) |
| Land | \$ 25 |
| Buildings | 6,555 |
| Machinery, equipment and tooling | 11,021 |
| | ----- |
| | 17,601 |
| Less accumulated depreciation and amortization | (11,721) |
| | ----- |
| | \$ 5,880 |
| | ===== |

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 March 31, 2007, accumulated amortization on the building amounted to approximately \$1,800,000. The associated current and long-term liabilities are discussed in Note 5 to the consolidated financial statements. Depreciation expense for the three months ended March 31, 2007 amounted to \$139,000 and \$172,000 for the same period in 2006. 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.

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5. LONG-TERM DEBT

| | March 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 (3.85% at March 31, 2007) (A) | \$ 3,810 |
| Term loan payable to a financial institution; interest at LIBOR plus 2%, not to exceed 6.00% (6.00% at March 31, 2007); quarterly principal payments of \$17,500; payable in full in the fourth quarter of 2009, partially secured by equipment | 343 |
| Term loan payable to a financial institution; interest at LIBOR plus 2% (7.24% at March 31, 2007); quarterly principal payments of \$26,786 through the fourth quarter of 2011 | 509 |
| Secured term loan payable to a government agency; monthly payments of approximately \$1,455 with interest waived payable through second quarter of 2012 | 121 |
| Secured term loan payable to a government agency; monthly payments of \$1,950 including interest fixed at 3% payable through fourth quarter of 2015 | 178 |
| | ----- |
| | 4,961 |
| Less current portion | (384) |
| | ----- |
| | \$ 4,577 |
| | ===== |

(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

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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 is no balance outstanding at March 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 March 31, 2007, the Company was in compliance with all of its debt covenants.

6. EMPLOYEE BENEFIT PLANS

During the fourth quarter of 2006, the Company gave notice of its intent to terminate its qualified defined benefit plans with a proposed

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termination date of October 31, 2006. The termination is expected to be settled during 2007. Included in the first quarter is approximately \$120,000 of accrued expenses related to the plan settlement in 2007. Benefits expected to be paid in the form of annuity and lump sum payments are approximately \$560,000 in 2007, which will be disbursed from the plans' funded assets. No additional Company contributions are anticipated in 2007.

7. INCOME TAXES

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes"--an interpretation of SFAS No. 109, "Accounting for Income Taxes" (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.

8. COMMON SHAREHOLDERS' EQUITY

| | Common stock | | (\$000's omitted) | | | | |
|--|-------------------------------|--------|--------------------------------------|----------------------|------------|-------------------|-----------------------|
| | Number of shares issued | Amount | Capital in excess of par value | Retained earnings | ESOP | Treasury stock | Oth compreh los |
| | | | | | | | |
| Balance December | | | | | | | |
| 31, 2006 | 2,614,506 | \$523 | \$13,033 | \$4,703 | (\$ 1,933) | (\$ 1,600) | (\$ 2 |
| | ===== | ===== | ===== | ===== | ===== | ===== | ===== |
| Net income | - | - | - | 204 | - | - | - |
| Purchase/receipt of treasury shares | - | - | - | - | - | (303) | - |
| Other | - | - | - | (1) | - | - | - |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Balance March 31, 2007 | 2,614,506 | \$523 | \$13,033 | \$4,906 | (\$ 1,933) | (\$ 1,903) | (\$ 2 |
| | ===== | ===== | ===== | ===== | ===== | ===== | ===== |

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 March 31, 2007, the Company has purchased 144,357 shares for a total of \$1,221,896 under this program.

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

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in the marketplace with the cash received upon stock option exercise.

| | Three Months Ended March 31, | |
|---|--|---------|
| | 2007 | 2006 |
| | ---- | ---- |
| | (\$000's omitted except per share data) | |
| Net income | \$ 204 | \$ 273 |
| | ===== | ===== |
| Weighted average common shares outstanding (basic) | 1,979 | 2,085 |
| Incremental shares from assumed conversions of stock options | 164 | 136 |
| | ----- | ----- |
| Weighted average common shares outstanding (diluted) | 2,143 | 2,221 |
| BASIC | | |
| Net income per share | \$ 0.10 | \$ 0.13 |
| | ===== | ===== |
| DILUTED | | |
| Net income per share | \$ 0.10 | \$ 0.12 |
| | ===== | ===== |

9. 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. Operations in 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 the government. 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 | | |
|--------------------------------------|------------------------------|----------|----------------------------|----------|----|
| | ----- | | ----- | | |
| | Three months ended | | Three months ended | | |
| | March 31, | | March 31, | | |
| | 2007 | 2006 | 2007 | 2006 | |
| | ---- | ---- | ---- | ---- | |
| Revenues from unaffiliated customers | \$ 3,930 | \$ 3,475 | \$ 2,600 | \$ 1,960 | \$ |
| | ===== | ===== | ===== | ===== | == |
| Profit (loss) | \$ 924 | \$ 825 | \$ (256) | \$ (214) | \$ |
| | ===== | ===== | ===== | ===== | |
| Interest expense | \$ (56) | \$ (54) | \$ (6) | \$ (7) | |
| | ===== | ===== | ===== | ===== | |
| Depreciation and amortization | \$ (97) | \$ (128) | \$ (42) | \$ (44) | |
| | ===== | ===== | ===== | ===== | |
| Other income, net | \$ 29 | \$ 231 | \$ 5 | \$ 12 | |
| | ===== | ===== | ===== | ===== | |
| General corporate expense | | | | | |

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Income before income taxes

10. 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.

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

MANAGEMENT DISCUSSION

During the three month period ended March 31, 2007 and for the comparable period ended March 31, 2006, approximately 34% and 28% respectively of the Company's revenues 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 have increased a net of approximately \$600,000 when comparing the results of 2007 to 2006 due to increased orders and shipments as well as expected differences in timing of government order placement and required shipping schedules at both the CPG and Advanced Technology Group (ATG). 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 Industry Association (AIA) stated that the civil aircraft sector was particularly strong and that, based on the current backlog of commercial aircraft orders and otherwise, they believe this upward trend will continue in 2007. The Company's Advanced Technology Group's revenue for the three month period ended March 31, 2007 reflects this upward trend and the Company anticipates, based on the ATG's current forecast, that the ATG's shipments should remain strong for 2007.

The Company's Consumer Products Group has developed products for government and military applications. Forecasted procurements for certain of these items are forming the basis for projected deliveries in 2007. Procurement proposals and product development activities are ongoing. The CPG received two significant contracts for CPG developed products for the military. The contracts amount to approximately \$4,000,000 and require deliveries in 2007 and into 2008.

See also Note 9 to 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

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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. Certain balances for the three month period ended March 31, 2006 were reclassified to conform with classifications adopted in the current year.

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| | Relationship to revenues three months ended March 31, | | Period to period \$ increase (decrease) |
|--|--|-------|--|
| | 2007 | 2006 | 07-06 |
| | ---- | ---- | ----- |
| Revenues | | | |
| Advanced Technology Group | 60.2% | 63.9% | \$ 455 |
| Consumer Products Group | 39.8 | 36.1 | 640 |
| | ---- | ---- | ----- |
| | 100.0 | 100.0 | 1,095 |
| Cost of goods sold, exclusive of depreciation | 78.4 | 75.9 | 992 |
| | ---- | ---- | ----- |
| Gross profit | 21.6 | 24.1 | 103 |
| | ---- | ---- | ----- |
| Selling, general and administrative | 14.0 | 16.3 | 25 |
| Interest | 0.9 | 1.1 | 1 |
| Depreciation and amortization | 2.1 | 3.2 | (33) |
| Other income, net | (0.5) | (4.5) | 209 |
| | ----- | ----- | ----- |
| | 16.5 | 16.1 | 202 |
| Income before income tax provision | 5.1 | 8.0 | (99) |
| Income tax provision | 2.0 | 3.0 | (30) |
| | --- | --- | ----- |
| Net income | 3.1% | 5.0% | \$ (69) |
| | === | === | ===== |

The Company's consolidated revenues increased approximately \$1,095,000 for the three month period ended March 31, 2007 when compared to the same three month period in 2006 as a result of increased shipments. The Company's CPG has recently received two significant contracts for CPG developed products for the military. These contracts amount to approximately \$4,000,000 and have schedules that start product deliveries in 2007 and continue into 2008.

Gross profit for the three month period ended March 31, 2007 increased by 7.9% as compared to the same three month period in 2006. Increased sales volume attributed to the dollar value increase in gross profit despite a decrease in gross profit as a percentage of sales that is affected by many factors including the mix of products sold in the period within the ATG and CPG as well as the composition of ATG and CPG sales to the total consolidated sales and, consistent with U.S. generally accepted accounting principles (GAAP), the expensing of preproduction and development costs as they are incurred.

Selling, general and administrative (SG&A) expenses that include variable costs increased by approximately \$25,000 or 2.8% for the three month period ended March 31, 2007 when compared to the same three month period in 2006. Expanded sales/marketing activities at both the ATG and the CPG as well as costs associated with the settlement of the Company's qualified defined benefit plans contribute to the increase. Also, consistent with GAAP, these costs are expensed as they are incurred and because of this may result in timing differences and fluctuations from period to period.

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Interest expense remained relatively consistent for the three month period ended March 31, 2007 when compared to the same three month period in 2006 despite increases in the market driven interest rates. 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. See also Note 5 to the consolidated financial statements for information on long-term debt.

Depreciation and amortization expense decreased approximately 19.2% for the three month period ended March 31, 2007 when compared to the same three month period in 2006 due to variable estimated useful lives of depreciable property (as identified in Note 2 to the consolidated financial statements) and the reduction in capital expenditures.

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. The decrease in other income for the three month period ended March 31, 2007 when compared to the same three month period in 2006 is primarily due

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to a \$193,000 partial payment of a recovery in 2006. There was no such recovery in 2007.

The Company's effective tax rate was 39% in 2007 and 37% in 2006. The effective tax rate in both years reflects state income taxes, permanent non-deductible expenditures and the tax benefit for extraterritorial sales as well as manufacturing deductions allowable under the American Jobs Creation Act of 2004. See also Note 7 to the consolidated financial statements for information concerning income tax.

Net income decreased \$69,000 when comparing the three month period ended March 31, 2007 to the same three month period in 2006. The decrease can more than be accounted for by a decrease in other income received in 2006 not related to the sale of the Company's products. This decrease was partially offset by an increase of \$110,000 in net income from operations resulting from increased consolidated revenues and the effects of cost containment activities that directly affect the after-tax reported income.

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 March 31 2007 the Company had working capital of approximately \$13.2 million of which \$4 million was comprised of cash and cash equivalents. The Company generated approximately \$329,000 in cash from operations in the first quarter of 2007. The most significant use of cash included payment of income taxes as well as increases in inventory levels related to timing of shipments of product.

At March 31, 2007, there are no material commitments for capital expenditures.

The Company had an increase in the uses of cash in its financing and investing activities in the first quarter of 2007 primarily related to capital expenditures for equipment, principle payments on long-term debt and investment in treasury shares of approximately \$303,000. In January of 2006, the Company's Board of Directors authorized the purchase by the Company of up to 250,000

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shares of its common stock in the open market or in privately negotiated transactions. As of March 31, 2007, the Company has purchased 144,357 shares under this program. The Company has financed this purchase program through its cash reserves.

The Company also has a \$1,000,000 line of credit on which there is no balance outstanding at March 31, 2007. If needed, this can be used to fund cash flow required for operations.

Item 3. CONTROLS AND PROCEDURES

(a) 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 March 31, 2007. 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.

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(b) CHANGES IN INTERNAL CONTROLS

During the three month period ended March 31, 2007, there were no changes in internal controls over financial reporting that have materially affected, or is reasonably likely to affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

None.

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

PURCHASES OF EQUITY SECURITIES BY THE COMPANY AND AFFILIATED PURCHASES

| Period | Total Number of Shares Purchased | Average Price \$ Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs |
|--------|----------------------------------|---------------------------------|--|
| ----- | ----- | ----- | ----- |

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| | | | |
|-----------------------|--------|------|--------|
| January 1 - 31, 2007 | - | - | - |
| February 1 - 28, 2007 | 3,866 | 8.34 | 3,866 |
| March 1 - 31, 2007 | 30,000 | 9.00 | 30,000 |
| Total | 33,866 | 8.92 | 33,866 |

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

Item 5. OTHER INFORMATION

None.

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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-QSB contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, such as those pertaining to the Company's capital resources and profitability. Forward-looking statements involve numerous risks and uncertainties. The Company derives a material portion of its revenues from contracts with agencies of the U.S. Government or their prime contractors. The Company's business is performed under fixed price contracts and the following factors, among others discussed herein, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements: uncertainties

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in today's global economy and global competition, and difficulty in predicting defense appropriations, the vitality of the commercial aviation industry and its ability to purchase new aircraft, the willingness and ability of the Company's customers to fund long-term purchase programs, and market demand and acceptance both for the Company's products and its customers' products which incorporate Company-made components. The success of the Company also depends upon the trends of the economy, including interest rates, income tax laws, governmental regulation, legislation, population changes and those risk factors discussed elsewhere in this Form 10-QSB. Readers are cautioned not to place undue reliance on forward-looking statements, which reflect management's analysis only as of the date hereof. The Company assumes no obligation to update forward-looking statements.

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SIGNATURES

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

Date: May 14, 2007

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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