

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

SERVOTRONICS INC /DE/  
Form 10KSB  
March 30, 2004

U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549  
FORM 10-KSB

X ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

-

For the fiscal year ended December 31, 2003

TRANSITION REPORT UNDER 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.

-----  
(Name of small business issuer as specified in its charter)

Delaware

16-0837866

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(I. R. S. Employer  
Identification No.)

1110 Maple Street, Elma, New York

14059

-----  
(Address of principal executive offices)

-----  
(Zip Code)

Issuer's telephone number: 716-655-5990  
-----

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class<br>-----  | Name of each exchange on<br>which registered<br>----- |
|-------------------------------|---|
| Common Stock, \$.20 par value | American Stock Exchange                               |

Securities registered pursuant to Section 12(g) of the Act: None

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 .

--- ---

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. X

---

Issuer's revenues for its most recent fiscal year: \$17,574,000

## Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

As of March 15, 2004 the aggregate market value of the voting common stock held by non-affiliates of the registrant was \$4,634,689.65 based on the average of sales prices reported by the American Stock Exchange on that day.

As of March 15, 2004 the number of \$.20 par value common shares outstanding was 2,492,901.

### DOCUMENTS INCORPORATED BY REFERENCE

| Document<br>-----   | Part of Form 10-KSB<br>----- |
|---|------------------------------|
| 2003 Proxy Statement  | Part III                     |
| Transitional Small Business Disclosure Format. Yes . No X . | --- ---                      |

### PART I -----

Item 1. Description of Business  
-----

General  
-----

Servotronics, Inc. and its subsidiaries (collectively the "Registrant" or the "Company") design, manufacture and market advanced technology products consisting primarily of control components and consumer products consisting of knives and various types of cutlery.

The Registrant was incorporated in New York in 1959. In 1972, the Registrant was merged into a wholly-owned subsidiary organized under the laws of the State of Delaware, thereby changing the Registrant's state of incorporation from New York to Delaware.

Products  
-----

Advanced Technology Products  
-----

The Registrant designs, manufactures and markets a variety of servo-control components which convert an electrical current into a mechanical force or movement and other related products. The principal servo-control components produced include torque motors, electromagnetic actuators, proportional solenoids, hydraulic valves, pneumatic valves and similar devices, all of which perform the same general function. These are sold principally to the commercial aerospace, missile, aircraft and government related industries.

To fill most of its orders for components, the Registrant must either modify a standard model or design a new item in order to satisfy the customer's particular requirements. The Registrant also produces unique products based on specifications provided by its customers. The Registrant produces under long-term contracts and other types of orders.

The Registrant also produces metallic seals of various cross-sectional configurations. These seals fit between two surfaces, usually metal, to produce a more secure and leak-proof joint. The Registrant manufactures these seals to close tolerances from standard and special alloy steels. Ductile coatings are often applied to the seals in order to increase their effectiveness.

From time to time, the Registrant has also produced other products of its own and/or of a given design to meet customers' requirements.

Consumer Products  
-----

The Registrant designs, manufactures and sells a variety of cutlery products. These products include a wide range of kitchen knives such as steak, carving, bread, butcher and paring knives for household use and for use in restaurants, institutions and private industry, and pocket and other types of knives for hunting, fishing and camping. The Registrant sells cutlery products to the U.S. Government and related agencies. These products include machetes, bayonets and other types of knives that are primarily for military use. The Registrant also produces and markets other cutlery items such as carving forks and various specialty tools such as putty knives, linoleum sheet cutters and field knives. The Registrant manufactures its cutlery products from stainless or high carbon steel in numerous styles, designs, models and sizes. Substantially all of the Registrant's commercial cutlery related products are intended for the medium to premium priced markets.

The Registrant sells many of its cutlery products under its own brand names including "Old Hickory" and "Queen."

Sales, Marketing and Distribution  
-----

Advanced Technology Products  
-----

The Registrant's advanced technology products are marketed throughout the United States and are essentially non-seasonal in nature. These products are sold to the United States Government, government prime contractors, government subcontractors, commercial manufacturers and end users. Sales are made primarily by the Registrant's professional staff and commissioned field engineering representatives.

During the Registrant's last fiscal year, sales of advanced technology products pursuant to subcontracts with prime or subcontractors for various branches of the United States Government or pursuant to prime contracts directly with the government accounted for approximately 30% of the Registrant's total revenues as compared to 22% in 2002. In 2003, sales of advanced technology products to each of Honeywell, Raytheon and United Technologies (including their respective subsidiaries and/or divisions) exceeded 10% of Registrant's total revenues. No other single customer represented more than 10% of the Company's revenues in 2003 or 2002.

The Registrant's prime contracts and subcontracts with the United States Government are subject to termination for the convenience of the Government. In

the event of such termination, the Registrant is ordinarily entitled to receive payment for its costs and profits on work done prior to termination. Since the inception of the Registrant's business, less than 1% of its Government contracts have been terminated for convenience.

Consumer Products  
-----

The Registrant's consumer products are marketed throughout the United

## Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

States. Consumer sales are moderately seasonal. Sales are to hardware, supermarket, variety, department, discount, gift and drug stores. The Registrant's Consumer Products Group also sells its cutlery products (principally machetes, bayonets, survival knives and kitchen knives) to various branches of the United States Government which accounted for approximately 12% of the Registrant's total sales in 2003 and approximately 1% of total sales in 2002. The Registrant sells its products through its own sales personnel and through independent manufacturers' representatives.

### Business Segments

-----

Business segment information is presented in Note 10 of the accompanying consolidated financial statements.

### Intellectual Properties

-----

The Company has rights under certain copyrights and registered domain names. In the view of management, the Registrant's competitive position is not dependent on patent protection.

### Research Activities

-----

The amount spent by the Registrant in research and development activities during its 2003 and 2002 fiscal years was not significant.

### Environmental Compliance

-----

The Registrant does not anticipate that the cost of compliance with current environmental laws will be material.

### Manufacturing

-----

The Registrant manufactures its consumer products in Franklinville, New York and Titusville, Pennsylvania and its advanced technology products in Elma, New York.

-4-

### Raw Materials and Other Supplies

-----

The Registrant purchases raw materials and certain components for its products from outside vendors. The Registrant is not generally dependent upon a single source of supply for any raw material or component used in its operations.

### Competition

-----

Although no reliable industry statistics are available to enable the Registrant to determine accurately its relative competitive position with respect to any of its products, the Registrant believes that it is a significant factor with respect to certain of its servo-control components. The Registrant's share of the overall cutlery market is not significant.

The Registrant encounters active competition with respect to its products from numerous companies, many of which are larger in terms of manufacturing

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

capacity, financial resources and marketing organization. Its principal competitors vary depending upon the customer and/or the products involved. The Registrant believes that it competes primarily with more than 20 companies with respect to its consumer products, in addition to foreign imports. To the Registrant's knowledge, its principal competitors with regard to cutlery include World Kitchen, Inc., Tramontina, Inc., Dexter-Russell Inc., W. R. Case & Sons Cutlery Company, Imperial Schrade Corporation, Lifetime Hoan Corp. and Camillus Cutlery Company.

The Registrant has many different competitors with respect to servo-control components because of the nature of that business and the fact that these products also face competition from other types of control components which, at times, can accomplish the desired result.

The Registrant markets most of its products throughout the United States. The Registrant believes that it competes in marketing its consumer products primarily on the basis of price, quality and delivery, and its control products primarily on the basis of operating performance, adherence to rigid specifications, quality, price and delivery.

Employees

-----

The Registrant, at December 31, 2003, had approximately 222 employees of which approximately 206 are full time. In excess of 82% of its employees are engaged in production, inspection, packaging or shipping activities. The balance are engaged in executive, engineering, administrative, clerical or sales capacities.

-5-

Item 2. Description of Properties

-----

-----

The Registrant's executive offices are located on premises leased by the Registrant at 1110 Maple Street, Elma, a suburb of Buffalo, New York. The Registrant owns and/or leases real property as set forth in the following table:

| Location                 | Approx. acreage | Principal product manufactured | Number of buildings and type of construction | Approx. floor area (sq.feet) |
|--------------------------|-----------------|--------------------------------|--|------------------------------|
| Elma, New York           | 38.4            | Advanced technology products   | 1-concrete block/steel                       | 82,000                       |
| Franklinville, New York  | 11.7            | Cutlery products               | 1-tile/wood and 1 concrete/metal             | 149,000                      |
| Titusville, Pennsylvania | .4              | Cutlery products               | 2-brick                                      | 25,000                       |

In Elma, New York, the Registrant leases approximately 38.4 acres of land and a facility from a local industrial development agency. The lease is accounted for as a capital lease and entitles the Registrant to purchase the property for a nominal amount.

See the consolidated financial statements, including Note 8 thereto, for further information with respect to the Registrant's lease commitments.

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

The Registrant possesses modern precision manufacturing and testing equipment suitable for the development, manufacture, assembly and testing of its advanced technology products. The Registrant designs and makes substantially all of the tools, dies, jigs and specialized testing equipment necessary for the production of the advanced technology products. The Registrant also possesses automatic and semi-automatic grinders, tumblers, presses and miscellaneous metal finishing machinery and equipment for use in the manufacture of consumer products.

Item 3. 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.

-6-

Item 4. Submission of Matters to a Vote of Security Holders  
-----

Not applicable.

-7-

PART II

Item 5. Market for Common Equity and Related Stockholder Matters  
-----

(a) Price Range of Common Stock  
-----

The following table shows the range of high and low prices for the Registrant's common stock as reported by the American Stock Exchange for 2003 and 2002.

|      |                | HIGH    | LOW     |
|------|----------------|---------|---------|
|      |                | ----    | ---     |
| 2003 |                |         |         |
|      | Fourth Quarter | \$ 3.55 | \$ 2.00 |
|      | Third Quarter  | 2.45    | 2.10    |
|      | Second Quarter | 2.28    | 1.85    |
|      | First Quarter  | 3.75    | 2.25    |
| 2002 |                |         |         |
|      | Fourth Quarter | \$ 4.00 | \$ 3.30 |
|      | Third Quarter  | 4.40    | 3.60    |
|      | Second Quarter | 5.20    | 4.40    |
|      | First Quarter  | 5.22    | 4.70    |

(b) Approximate number of holders of common stock

| Title<br>of<br>class<br>----- | Approximate number of<br>record holders (as of<br>December 31, 2003)<br>----- |
|-------------------------------|---|
|-------------------------------|---|

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

Common Stock, \$.20 par value per share 586

(c) Dividends on common stock

No cash dividends were paid in 2003 or 2002.

-8-

Item 6. Management's Discussion and Analysis or Plan of Operation

The following table sets forth for the period indicated the percentage relationship of certain items in the consolidated statement of operations to net revenues and the percentage increase or decrease of such items as compared to the indicated prior period.

|   | Relationship to<br>net revenues year<br>ended |        | Period to<br>period<br>increase<br>(decrease) |
|---|---|--------|---|
|   | December 31,<br>2003                          | 2002   | year ended<br>2003-2002                       |
| Net revenues:                                 |   |        |   |
| Advanced technology products                  | 58.5%   | 65.4 % | 0.7%  |
| Consumer products                             | 41.5  | 34.6   | 35.1  |
|   | -----   | -----  | -----   |
|   | 100.0   | 100.0  | 12.6  |
| Cost of goods sold, exclusive of depreciation | 74.4  | 77.5   | 8.0   |
|   | -----   | -----  | -----   |
| Gross profit                                  | 25.6  | 22.5   | 28.4  |
|   | -----   | -----  | -----   |
| Selling, general and administrative           | 18.6  | 19.1   | 9.9   |
| Interest                                      | 0.9   | 1.3    | (18.4)  |
| Depreciation and amortization                 | 3.8   | 4.2    | 1.4   |
|   | -----   | -----  | -----   |
|   | 23.3  | 24.6   | 7.0   |
|   | -----   | -----  | -----   |
| Income (loss) before income taxes             | 2.3   | (2.1)  | 226.1   |
| Income tax provision (benefit)                | 0.9   | (0.6)  | 263.4   |
|   | -----   | -----  | -----   |
| Net income (loss)                             | 1.4%  | (1.5)% | 210.9%  |
|   | =====   | =====  | =====   |

-9-

Management Discussion

During the year ended December 31, 2003 and for the comparable period ended December 31, 2002, approximately 42% and 23% respectively of the Company's revenues were derived from contracts with agencies of the U.S. Government or their prime contractors and their subcontractors. Continued government involvement in military operations overseas has had a direct impact on the financial results in both the Advanced Technology and Consumer Product's markets. Sales of products sold for government applications have increased approximately \$3,800,000 over 2002 and are expected to remain strong. While the Company remains optimistic in relation to these opportunities, it recognizes that sales to the government are affected by defense budgets, U.S. and foreign

## Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

policy and the level of military operations and as such, it is difficult to predict the impact on future financial results.

See also Note 10 to the consolidated financial statements for information concerning business segment operating results.

### Results of Operations - Year 2003 as Compared to 2002

-----

The Company's consolidated results of operations for the year ended December 31, 2003 showed an approximate \$2,000,000 or 12.6% increase in net revenues with a turnaround in income before taxes of approximately \$728,000. The increase in revenues is primarily attributed to increased government shipments.

Gross profit increased 28.4% for the twelve month period ended December 31, 2003. During 2002, the Company incurred significant front-end costs associated with prototype, preproduction and start-up activities for Consumer Products Group's combination combat knife and bayonet. The majority of such up-front costs were incurred and expensed in 2002 and early 2003. While the Company continues to incur such costs on an ongoing basis associated with products for both the Advanced Technology Group (ATG) and Consumer Products Group (CPG), the timing of such costs directly contributes to the fluctuation in gross profit from period to period as these costs are expensed as they occur and, as such, are not matched to their future revenues and benefits. Another factor contributing to the increase in gross profit for the reported period is product mix.

Selling, general and administrative (SG&A) costs increased approximately 10% when compared to the same period in 2002. The increase in SG&A costs is primarily attributed to increased marketing of the expanded sales effort of the ATG and CPG and the increased costs for professional services and corporate governance necessitated by the Sarbanes-Oxley Act and related regulations that are expected to continue to be significant expense factors.

-10-

Interest expense decreased for the year ended December 31, 2003 when compared to the same period in 2002 due to market driven interest rate fluctuations and the decrease of institutional debt.

Depreciation and amortization expense increased approximately 1.4% for the year ended December 31, 2003 when compared to the same period in 2002 due to variable estimated useful lives of depreciable property as identified in Note 1 to the consolidated financial statements.

The Company's effective tax rate (benefit) was 37% in 2003 compared to (29%) in 2002. The variance in the effective tax rate is primarily attributable to state income taxes, permanent non-deductible expenditures and the tax benefit on certain foreign sales.

### Results of Operations - Year 2002 as Compared to 2001

-----

The Company's consolidated results of operations for the year ended December 31, 2002 showed an approximate 13% decrease in net revenues with a decrease in net income of approximately 132.8%. The decrease in net revenues is primarily attributable to a decrease in revenue at the Advanced Technology Group of \$1,973,000 and a decrease in revenue of \$355,000 at the Consumer Products Group. The decrease in revenues for the twelve month period ended December 31, 2002 can be attributed to the overall continued economic softness in the aerospace industry and previously reported reductions and stretch-outs in the commercial markets for the advanced technology products combined with a loss of



## Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

revenues at the Consumer Products Group due both to a regionalization of markets by a significant customer, certain reprioritizations of government procurements and the general decline in retail markets for edged products (i.e., knives, etc.)

Gross profit decreased for the twelve month period ended December 31, 2002 primarily due to a decrease in net revenues along with increased expenses to expand the capabilities of our current product lines and resources expended to modify and adapt existing and new products for additional applications in both the aerospace industry as well as other markets. As previously reported, recent changes in accounting rules do not allow for the deferment of pre-production and/or start-up costs and, as such, they are reflected in cost of goods sold for the year ended December 31, 2002 with no, or minimal, benefit to revenue in the current period. Although the current year's gross margin was negatively impacted by the cyclical and costly nature of pre-production and/or prototype expenses, these long-term investments are necessary and have the potential to provide substantial positive effects on the funded and unfunded backlogs.

Selling, general and administrative costs increased for the year ended December 31, 2002 as a percentage of sales when compared to the same period in

-11-

2001. This can be attributed to a smaller percentage of expenses that are dependent upon sales levels and a greater percentage reflecting fixed general and administrative costs. Further, the Company has incurred expenses for costs dedicated to merger/acquisition evaluations, expanded sales and marketing activities, and additional procedures and professional expenses to assure the integrity of financial reporting and corporate disclosure following passage of the Sarbanes-Oxley Act in 2002.

Interest expense as a percentage of long-term debt decreased for the year ended December 31, 2002 when compared to the same period in 2001 due to market driven interest rate fluctuations and the decrease of institutional debt.

Depreciation expense increased due to variable estimated useful lives of depreciable property as identified in Note 1 to the consolidated financial statements.

The Company's effective tax rate (benefit) was (29%) in 2002 compared to 37% in 2001. The variance in the effective tax rate is primarily attributable to state income taxes, permanent non-deductible expenditures and the tax benefit on certain foreign sales

### Liquidity and Capital Resources

-----  
The Company's primary liquidity and capital requirements relate to the working capital needs; primarily inventory, accounts receivable, capital investments in facilities, machinery, tools/dies and equipment and principal/interest payments on indebtedness. The Company's primary sources of liquidity have been from positive cash flows and from bank financing.

During the year ended December 31, 2003, the Company expended \$148,000 on capital expenditures as compared to \$717,000 in 2002.

There are no other material commitments for capital expenditures at December 31, 2003.

The Company also has a \$1,000,000 line of credit on which there is no balance outstanding at December 31, 2003.

## Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

Principal maturities of long-term debt are as follows: 2004 - \$463,000; 2005 - \$418,000; 2006 - \$312,000, 2007 - \$278,000; 2008 and thereafter - \$4,203,000.

### Off Balance Sheet Arrangements

-----

None.

-12-

### Critical Accounting Policies

-----

The Company prepares our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that the Company believes are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the periods presented. Actual results could differ significantly from those estimates under different assumptions and conditions. The Company believes that the following discussion addresses our most critical accounting policies, which are those that are most important to the portrayal of our financial condition and results of operations and which require our most difficult and subjective judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Note 1 to the accompanying consolidated financial statements includes a summary of the significant accounting policies used in the preparation of the consolidated financial statements.

### New Accounting Pronouncements

-----

Management reviewed recent accounting pronouncements and does not feel that they will have a significant impact on Financial Statement results. See Note 1 to the accompanying consolidated financial statements for further discussion of new accounting pronouncements.

### Revenue Recognition

-----

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

Included in other current assets is \$825,000 of unbilled revenues which represents revenue earned under the percentage of completion method (cost-to-cost) not yet billable under the terms of the contracts.

### Inventories

-----

Inventories are stated generally at the lower of standard cost and net realizable value. Cost includes all cost incurred to bring each product to its present location and condition, which approximates actual cost (first-in,

-13-

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

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.

Use of Estimates  
-----

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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.

Item 7. Financial Statements  
-----

The financial statements of the Registrant which are included in this Form 10-KSB Annual Report are described in the accompanying Index to Consolidated Financial Statements on Page F1.

Item 8. Changes in and Disagreements With Accountants On Accounting and  
-----  
Financial Disclosure  
-----

None.

Item 8a. Controls and Procedures  
-----

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

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

-14-

PART III  
-----

Item 9. Directors, Executive Officers, Promoters and Control Persons;  
-----  
Compliance With Section 16(A) of the Exchange Act  
-----

Information regarding directors and executive officers of the Registrant is incorporated herein by reference to the information included in the Registrant's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Registrant's 2003 fiscal year or such information will be included by amendment.

Code of Ethics  
-----

## Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

As of the date of this Form 10-KSB, the Company has not adopted a Code of Ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. The Company is currently in the process of developing a Code of Ethics and Business Conduct that will apply to all directors, officers and employees of the Company as required by the listing standards of the American Stock Exchange. Once adopted, the Code will be available on the Company's website at [www.servotronics.com](http://www.servotronics.com) and the Company intends to disclose on this website any amendment to the Code. Waivers under the Code, if any, will be disclosed under the rules of the SEC and the American Stock Exchange.

### Item 10. Executive Compensation

Information regarding executive compensation is incorporated herein by reference to the information included in the Registrant's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Registrant's 2003 fiscal year or such information will be included by amendment.

### Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information regarding security ownership of certain beneficial owners and management is incorporated herein by reference to the information included in the Registrant's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Registrant's 2003 fiscal year or such information will be included by amendment.

### Item 12. Certain Relationships and Related Transactions

Information regarding certain relationships and related transactions is incorporated herein by reference to the information included in the Registrant's

-15-

definitive proxy statement if it is filed with the Commission within 120 days after the end of the Registrant's 2003 fiscal year or such information will be included by amendment.

-16-

### Item 13. Exhibits and Reports on Form 8-K

#### (a) Exhibits

| Exhibit<br>number | Presentation   | Reference                              |
|-------------------|--|--|
| 3(A)(1)           | Certificate of Incorporation   | Exhibit 3(A)(1) to 199<br>Form 10-KSB* |
| 3(A)(2)           | Amendments to Certificate<br>of Incorporation dated<br>August 27, 1984 | Exhibit 3(A)(2) to 199<br>Form 10-KSB* |

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

|           |  |                                      |
|-----------|--|--------------------------------------|
| 3(A)(3)   | Certificate of designation regarding Series I preferred stock  | Exhibit 4(A) to 1987 Form 10-K*      |
| 3(A)(4)   | Amendments to Certificate of Incorporation dated June 30, 1998   | Exhibit 3(A)(4) to 1999 Form 10-KSB* |
| 3(B)      | By-laws  | Exhibit 3(B) to 1986 Form 10-K*      |
| 4.1(A)    | First amended and restated term loan agreement with Fleet Bank of New York dated October 4, 1993                       | Exhibit 4(A) to 1993 Form 10-KSB*    |
| 4.1(B)    | Second amended and restated term loan agreement with Fleet Bank of New York dated February 26, 1999                    | Exhibit 4.1(B) to 1999 Form 10-KSB*  |
| 4.1(C)    | First amendment to second amended and restated term loan agreement with Fleet Bank of New York dated December 17, 1999 | Exhibit 4.1(C) to 1999 Form 10-KSB*  |
| 4.2(A)(1) | Letter of Credit Reimbursement Agreement with Fleet Bank dated December 1, 1994  | Exhibit 4(B)(1) to 1994 10-KSB*      |

-----  
 \*Incorporated herein by reference (File No. 1-07109)

\*\*Indicates management contract or compensatory plan or arrangement

-17-

| Exhibit<br>number<br>----- | Presentation<br>-----   | Reference<br>-----                  |
|----------------------------|---|-------------------------------------|
| 4.2(B)                     | First Amendment and Extension to Letter of Credit and Reimbursement Agreement with Fleet Bank of New York dated as of December 17, 1999 | Exhibit 4.2(B) to 1999 Form 10-KSB* |
| 4.2(B)(2)                  | Agency Mortgage and Security Agreement dated as of December 1, 1994 from the Registrant and its subsidiaries                            | Exhibit 4(B)(2) to 1994 10-KSB*     |
| 4.2(B)(3)                  | Guaranty Agreement dated as of December 1, 1994 from the Registrant and its   | Exhibit 4(B)(3) to 1994 10-KSB*     |

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

subsidiaries to the Erie  
County Industrial  
Development Agency  
("ECIDA"), Norwest Bank  
Minnesota, N.A., as Trustee,  
and Fleet Bank

|           |  |   |
|-----------|--|---|
| 4.3       | Shareholder Rights Plan<br>dated as of August 27,<br>2002  | Exhibit 4 to Form<br>8-K filed August 27<br>2002* |
| 10(A) (1) | Employment contract**  | Exhibit 10(A) to 1986<br>Form 10-K*               |
| 10(A) (2) | Amendment to employment<br>contract**  | Filed herewith                                    |
| 10(A) (3) | Amendment to employment<br>contract**  | Filed herewith                                    |
| 10(B)     | Form of Indemnification<br>Agreement between the<br>Registrant and each of<br>its Directors and Officers** | Exhibit 10(E) to 1986<br>Form 10-K*               |

-----  
\*Incorporated herein by reference (File No. 1-07109)

\*\*Indicates management contract or compensatory plan or arrangement

-18-

| Exhibit<br>number<br>----- | Presentation<br>-----  | Reference<br>-----  |
|----------------------------|--|---|
| 10(C) (1)                  | Loan agreement between<br>the Company and its<br>employee stock ownership<br>trust, as amended | Exhibit 10(C) (1)<br>to 1991 Form 10-K*                       |
| 10(C) (2)                  | Stock purchase agreement<br>between the Company<br>and its employee<br>stock ownership trust   | Exhibit 10(D) (2) to<br>1988 Form 10-K*                       |
| 10(D) (1) (a)              | 1989 Employees Stock<br>Option Plan**  | Exhibit A to Form 8:<br>Amendment No. 1 to<br>1988 Form 10-K* |
| 10(D) (1) (b)              | Amendment to 1989<br>Employees Stock Option<br>Plan**  | Exhibit 10(D) (1) (b) to<br>Form 10-K*                        |
| 10(D) (1) (c)              | Amendment No. 2 to 1989<br>Employees Stock Option<br>Plan**                                    | Exhibit 10(D) (1) (d) to<br>Form 10-K*                        |

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

|               |   |  |
|---------------|---|--|
| 10(D) (1) (d) | 2000 Employees Stock<br>Option Plan**   | Exhibit 10(D) (1) (a) to<br>Form 10-KSB* |
| 10(D) (2)     | Stock Option Agreement<br>for Donald W. Hedges<br>dated March 24, 1998**        | Exhibit 10(D) (2) to 199<br>Form 10-KSB* |
| 10(D) (2) (a) | Stock Option Agreement<br>for Donald W. Hedges<br>dated July 7, 2000**          | Exhibit 10(D) (2) (a) to<br>Form 10-KSB* |
| 10(D) (3) (b) | Stock Option Agreement<br>for Nicholas D.<br>Trbovich dated<br>March 24, 1998** | Exhibit 10(D) (3) (b) to<br>Form 10-KSB* |
| 10(D) (3) (c) | Stock Option Agreement<br>for Nicholas D.<br>Trbovich dated<br>July 7, 2000**   | Exhibit 10(D) (3) (c) to<br>Form 10-KSB* |

-----  
\*Incorporated herein by reference (File No. 1-07109)

\*\*Indicates management contract or compensatory plan or arrangement

-19-

| Exhibit<br>number<br>----- | Presentation<br>-----   | Reference<br>-----                       |
|----------------------------|---|--|
| 10(D) (4)                  | Stock Option Agreement<br>for William H. Duerig<br>dated March 24, 1998**   | Exhibit 10(D) (4) to 19<br>Form 10-KSB*  |
| 10(D) (4) (a)              | Stock Option Agreement<br>for William H. Duerig<br>dated July 7, 2000**   | Exhibit 10(D) (4) (a) to<br>Form 10-KSB* |
| 10(D) (9)                  | Land Lease Agreement<br>between TSV, Inc.<br>(wholly-owned subsidiary<br>of the Registrant) and the<br>ECIDA dated as of May 1,<br>1992, and Corporate<br>Guaranty of the Registrant<br>dated as of May 1, 1992 | Exhibit 10(D) (9) to 19<br>Form 10-KSB*  |
| 10(D) (10)                 | Amendment to Land Lease<br>Agreement and Interim<br>Lease Agreement dated<br>November 19, 1992  | Exhibit 10(D) (11) to<br>Form 10-KSB*    |
| 10(D) (11)                 | Lease Agreement dated as of<br>December 1, 1994 between   | Exhibit 10(D) (11) to<br>1994 10-KSB*    |

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

the Erie County Industrial  
Development Agency  
("ECIDA") and TSV, Inc.

|            |   |                                       |
|------------|---|---------------------------------------|
| 10(D) (12) | Sublease Agreement dated<br>as of December 1, 1994<br>between TSV, Inc. and<br>the Registrant | Exhibit 10(D) (12) to<br>1994 10-KSB* |
| 10(D) (13) | 2001 Long-Term Stock<br>Incentive Plan  | Appendix A to 2001<br>Proxy**         |
| 21         | Subsidiaries of the<br>Registrant   | Exhibit 21 to 2001<br>10-KSB*         |

-----  
\*Incorporated herein by reference (File No. 1-07109)

\*\*Indicates management contract or compensatory plan or arrangement

-20-

| Exhibit<br>number<br>----- | Presentation<br>-----   | Reference<br>----- |
|----------------------------|---|--------------------|
| 23                         | Consent of Independent<br>Accountants Consent on<br>Form S-8 dated March 22, 2004   | Filed herewith     |
| 31.1                       | Certification of Chief Financial<br>Officer pursuant to<br>Rule 13a-14 or 15d-14 of the<br>Securities Exchange act of<br>1934, as adopted pursuant to<br>Section 302 of the Sarbanes-<br>Oxley Act of 2002. | Filed herewith     |
| 31.2                       | Certification of Chief Executive<br>Officer pursuant to<br>Rule 13a-14 or 15d-14 of the<br>Securities Exchange act of<br>1934, as adopted pursuant to<br>Section 302 of the Sarbanes-<br>Oxley Act of 2002. | Filed herewith     |
| 32.1                       | Certification of Chief Financial<br>Officer pursuant to 18 U.S.C.<br>1350 as adopted pursuant to<br>Section 906 of the Sarbanes-<br>Oxley Act of 2002.  | Filed herewith     |
| 32.2                       | Certification of Chief Executive<br>Officer pursuant to 18 U.S.C.<br>1350 as adopted pursuant to<br>Section 906 of the Sarbanes-<br>Oxley Act of 2002.  | Filed herewith     |



Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

The Registrant hereby agrees that it will furnish to the Securities and Exchange Commission upon request a copy of any instrument defining the rights of holders of long-term debt not filed herewith.

(b) Reports on Form 8-K

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

-----  
\*Incorporated herein by reference (File No. 1-07109)

\*\*Indicates management contract or compensatory plan or arrangement

-21-

Item 14. Principal Accountant Fees and Services  
-----

Information regarding principal accountant fees and services is incorporated herein by reference to the information included in the Registrant's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Registrant's 2003 fiscal year or such information will be included by amendment.

FORWARD-LOOKING STATEMENTS

In addition to historical information, certain sections of this Form 10-KSB 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, global competition, 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-KSB. Readers are cautioned not to place undue reliance on forward-looking statements, which reflect management's analysis only as the date hereof. The Company assumes no obligation to update forward-looking statements.

-22-

SIGNATURES  
-----



Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

|  |        |
|--|--------|
| Report of independent auditors   | F2     |
| Consolidated balance sheet at December 31, 2003  | F3     |
| Consolidated statement of operations for the years ended<br>December 31, 2003 and 2002 | F4     |
| Consolidated statement of cash flows for the years ended<br>December 31, 2003 and 2002 | F5     |
| Notes to consolidated financial statements   | F6-F21 |

Financial statement schedules are omitted because they are not applicable or the required information is shown in the financial statements or the notes thereto.

-F1-

Report of Independent Auditors  
-----

To the Board of Directors and Shareholders of  
Servotronics, Inc. and Subsidiaries

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations and cash flows present fairly, in all material respects, the financial position of Servotronics, Inc. (the "Company") and its subsidiaries at December 31, 2003, and the results of their operations and their cash flows for the years ended December 31, 2003 and 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion

PricewaterhouseCoopers LLP

Buffalo, New York  
March 22, 2004

-F2-

SERVOTRONICS, INC. AND SUBSIDIARIES  
-----

CONSOLIDATED BALANCE SHEET  
-----

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

|                 |              |
|-----------------|--------------|
|                 | December 31, |
| Assets          | 2003         |
|                 | ----         |
| Current assets: |              |

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

|  |    |         |
|--|----|---------|
| Cash   | \$ | 1,506   |
| Accounts receivable  |    | 2,488   |
| Inventories  |    | 6,810   |
| Prepaid income taxes   |    | 73      |
| Deferred income taxes  |    | 368     |
| Other assets (See Note 1 to consolidated financial statements)                         |    | 1,586   |
|  |    | -----   |
| Total current assets   |    | 12,831  |
| Property, plant and equipment, net   |    | 6,560   |
| Other non-current assets   |    | 550     |
|  |    | -----   |
|  | \$ | 19,941  |
|  |    | =====   |
| Liabilities and Shareholders' Equity   |    |         |
| Current liabilities:   |    |         |
| Current portion of long-term debt  | \$ | 463     |
| Accounts payable   |    | 549     |
| Accrued employee compensation and benefit costs  |    | 732     |
| Other accrued liabilities  |    | 175     |
|  |    | -----   |
| Total current liabilities  |    | 1,919   |
| Long-term debt   |    | 5,211   |
| Deferred income taxes  |    | 358     |
| Other non-current liabilities  |    | 244     |
| Shareholders' equity:  |    |         |
| Common stock, par value \$.20; authorized<br>4,000,000 shares; issued 2,614,506 shares |    | 523     |
| Capital in excess of par value   |    | 13,033  |
| Retained earnings  |    | 1,516   |
| Accumulated other comprehensive loss   |    | (107)   |
|  |    | -----   |
|  |    | 14,965  |
| Employee stock ownership trust commitment  |    | (2,236) |
| Treasury stock, at cost 121,605 shares   |    | (520)   |
|  |    | -----   |
| Total shareholders' equity   |    | 12,209  |
|  |    | -----   |
|  | \$ | 19,941  |
|  |    | =====   |

See notes to consolidated financial statements

-F3-

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

| Year Ended<br>December 31, |       |
|----------------------------|-------|
| 2003                       | 2002  |
| -----                      | ----- |

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

|   |           |           |
|---|-----------|-----------|
| Net revenues                                  | \$ 17,574 | \$ 15,607 |
| Costs and expenses:                           |           |           |
| Cost of goods sold, exclusive of depreciation | 13,067    | 12,096    |
| Selling, general and administrative           | 3,272     | 2,977     |
| Interest                                      | 160       | 196       |
| Depreciation and amortization                 | 669       | 660       |
|   | -----     | -----     |
|   | 17,168    | 15,929    |
|   | -----     | -----     |
| Income (loss) before income taxes             | 406       | (322)     |
| Income tax provision (benefit)                | 152       | (93)      |
|   | -----     | -----     |
| Net income (loss)                             | \$ 254    | \$ (229)  |
|   | =====     | =====     |
| Income (Loss) Per Share:                      |           |           |
| Basic   |           |           |
| -----   |           |           |
| Net income (loss) per share                   | \$ 0.13   | \$ (0.12) |
|   | =====     | =====     |
| Diluted                                       |           |           |
| -----   |           |           |
| Net income (loss) per share                   | \$ 0.13   | \$ (0.12) |
|   | =====     | =====     |

See notes to consolidated financial statements

-F4-

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

|  | Year Ended<br>December 31, |          |
|--|----------------------------|----------|
|  | 2003                       | 2002     |
|  | -----                      | -----    |
| Cash flows related to operating activities:  |                            |          |
| Net income (loss)  | \$ 254                     | \$ (229) |
| Adjustments to reconcile net income (loss) to net<br>cash provided by operating activities - |                            |          |
| Depreciation and amortization  | 669                        | 660      |
| Deferred income taxes  | 184                        | (97)     |
| Change in assets and liabilities -   |                            |          |
| Accounts receivable  | 145                        | 66       |
| Inventories  | (47)                       | 276      |
| Prepaid income taxes   | 72                         | (48)     |
| Other assets   | (125)                      | 628      |
| Other non-current assets   | 24                         | (9)      |
| Accounts payable   | 131                        | (442)    |
| Accrued employee compensation and benefit costs  | (57)                       | 103      |

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

|  |          |        |
|--|----------|--------|
| Other accrued liabilities                          | 66       | (77)   |
| Other non-current liabilities                      | (64)     | (8)    |
| Employee stock ownership trust payment             | 101      | 101    |
|  | -----    | -----  |
| Net cash provided by operating activities          | 1,353    | 924    |
|  | -----    | -----  |
| Cash flows related to investing activities:        |          |        |
| Capital expenditures - property, plant & equipment | (148)    | (717)  |
|  | -----    | -----  |
| Net cash used in investing activities              | (148)    | (717)  |
|  | -----    | -----  |
| Cash flows related to financing activities:        |          |        |
| Increase in demand loan                            | 250      | 400    |
| Acquisition of long-term debt                      | 0        | 500    |
| Payments on demand loan                            | (250)    | (600)  |
| Principal payments on long-term debt               | (378)    | (548)  |
|  | -----    | -----  |
| Net cash used in financing activities              | (378)    | (248)  |
|  | -----    | -----  |
| Net increase (decrease) in cash                    | 827      | (41)   |
| Cash at beginning of period                        | 679      | 720    |
|  | -----    | -----  |
| Cash at end of period                              | \$ 1,506 | \$ 679 |
|  | =====    | =====  |

Supplemental disclosures:

=====

|                              |          |        |
|------------------------------|----------|--------|
| Income taxes (received) paid | (\$ 131) | \$ 132 |
| Interest paid                | \$ 154   | \$ 226 |

See notes to consolidated financial statements

-F5-

SERVOTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-----

1. Summary of significant accounting policies

-----

The principal accounting policies of Servotronics, Inc. (the "Company") and subsidiaries are as follows:

Principles of consolidation

-----

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

Cash and cash equivalents

-----

The Company considers cash and cash equivalents to include all cash accounts and short-term investments purchased with a maturity of three months or less.

Revenue recognition

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

Included in other current assets is \$825,000 of unbilled revenues which represents revenue earned under the percentage of completion method (cost-to-cost) not yet billable under the terms of the contracts.

Inventories  
-----

Inventories are stated generally 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), and 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.

-F6-

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 retirement or 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 and its subsidiaries file a consolidated federal income tax return and separate state income tax returns.

The Company follows the asset and liability approach to account for income taxes. This approach 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.

## Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

### Employee stock ownership plan -----

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

### Use of estimates -----

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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.

-F7-

### New accounting pronouncements -----

In November 2002, the FASB issued FASB Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". FIN No. 45 requires the recognition of a liability for certain guarantee obligations issued or modified after December 31, 2002. FIN No. 45 also clarifies disclosure requirements to be made by a guarantor of certain guarantees. The disclosure provisions of FIN No. 45 are effective for fiscal years ending after December 15, 2002. The adoption of FIN No. 45 did not have a material impact on the Company's results of operations, financial position or cash flows.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities." The FASB's stated intent in issuing FIN 46 was to clarify the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 requires an enterprise to consolidate a variable interest entity (as defined in FIN 46) if that enterprise has a variable interest (or combination of variable interests) that will absorb a majority of the entity's expected losses if they occur, receive a majority of the entity's expected returns if they occur, or both. In December 2003, the FASB issued a revised FIN 46 ("FIN 46R") which attempts to clarify the guidance in the original interpretation. FIN 46 applies to variable interest entities created after January 31, 2003. FIN 46 also applies to all variable interest entities created prior to February 1, 2003 that are considered to be special-purpose entities (as defined in FIN 46R) as of December 31, 2003. FIN 46R must be applied to all variable interest entities no later than the end of the first reporting period that ends after March 15, 2004. This provision did not have a material impact on the Company's results of operations, financial position or cash flows.

In January 2003, the FASB issued EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor". This EITF addresses the accounting by a vendor for consideration (vendor allowances) given to a customer, including a reseller of the vendor's products, and the accounting by a reseller for cash consideration received from a vendor. It is effective for certain arrangements entered



## Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

into after November 21, 2002, and for all new arrangements, including modifications to existing arrangements, entered into after December 31, 2002. The adoption of this standard did not have a material impact on the Company's financial position, results of operations or cash flows.

-F8-

### Risk Factors

-----

The aviation and aerospace industries as well as markets for the Company's consumer products are facing new and different 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, global competition, the effect of terrorism, difficulty in predicting defense and other government appropriations, the vitality of the commercial aviation industry and its ability to purchase new aircraft, the willingness and ability of the Company's customers to fund long-term purchase programs, volatile market demand and the continued market acceptance of the Company's advanced technology and cutlery products make it difficult to predict the impact on future financial results.

|    |  |   |
|----|--|---|
| 2. | Inventories<br>-----                                     | December 31, 2003<br>-----<br>(\$000's omitted) |
|    | Raw materials and common parts                           | \$ 1,112  |
|    | Work-in-process  | 5,341   |
|    | Finished goods   | 593   |
|    |  | -----   |
|    |  | 7,046   |
|    | Less: common parts expected to be used<br>after one year | (236)   |
|    |  | -----   |
|    |  | \$ 6,810<br>=====                               |

|    |  |   |
|----|--|---|
| 3. | Property, plant and equipment<br>----- | December 31, 2003<br>-----<br>(\$000's omitted) |
|    | Land                                   | \$ 25   |
|    | Buildings                              | 6,452   |
|    | Machinery, equipment and tooling       | 9,760   |
|    |  | -----   |
|    |  | 16,237  |
|    | Less accumulated depreciation          | (9,677)   |
|    |  | -----   |
|    |  | \$ 6,560<br>=====                               |

Property, plant and equipment includes land and building under a \$5,000,000 capital lease which can be purchased for a nominal amount at the end of the lease term. The Company believes that it maintains property and casualty insurance in amounts adequate for the risk and nature of its assets and operations and which are generally customary in its industry.

-F9-

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

| 4. Long-term debt   | December 31, 2003 |
|---|-------------------|
| -----   | -----             |
|   | (\$000's omitted) |
| Industrial Development Revenue Bonds; secured by a letter of credit from a bank with interest payable monthly at a floating rate (1.53% at December 31, 2003)   | \$ 4,320          |
| Term loan payable to a financial institution interest at LIBOR plus 2% (3.16% at December 31, 2003); quarterly principal payments of \$17,500 commencing January 1, 2005; payable in full October 1, 2009 | 500               |
| Term loan payable to a financial institution interest at a rate of 3.4% at December 31, 2003; quarterly principal payments of \$35,714 through February 1, 2006   | 321               |
| Secured term loan payable to a government agency interest fixed at 6%, monthly payments of \$2,778; payable in full second quarter of 2004  | 117               |
| Secured term loan payable to a government agency interest fixed at 6%, monthly payments of \$2,774 through second quarter of 2012   | 180               |
| Secured term loan payable to a government agency interest fixed at 3%; monthly payments of \$1,950 through fourth quarter of 2015   | 236               |
|   | -----             |
|   | 5,674             |
| Less current portion  | (463)             |
|   | -----             |
|   | \$ 5,211          |
|   | =====             |

Industrial Development Revenue Bonds were issued by a government agency to finance the construction of the Company's headquarters/Advanced Technology facility. Annual sinking fund payments of \$170,000 commenced December 1, 2000 and continue through 2013, with a final payment of \$2,620,000 due December 1, 2014. The Company has agreed to reimburse the issuer of the letter of credit if there are draws on that letter of credit. The Company pays the letter of credit bank an annual fee of 1% of the amount secured thereby and pays the remarketing agent for the bonds an annual fee of .25% of the principal amount outstanding. The Company's interest under the facility capital lease has been pledged to secure its obligations to the government agency, the bank and the bondholders.

Principal maturities of long-term debt are as follows: 2004 - \$463,000; 2005 - \$418,000; 2006 - \$312,000, 2007 - \$278,000; 2008 and thereafter - \$4,203,000.

-F10-

The Company also has a \$1,000,000 line of credit on which there is no balance outstanding at December 31, 2003. The average interest rate on draw-downs for 2003 was 4%.

## Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

Certain lenders require the Company to comply with debt covenants as described in the specific loan documents, including the loan-to-value ratio, the interest coverage ratio, the fixed charge coverage ratio and the dividend payout ratio. At December 31, 2003, the Company was in compliance with all of its debt covenants.

### 5. Employee benefit plans

#### Employee stock ownership plan (ESOP)

Under the Company's ESOP adopted in 1985, participating employees are awarded shares of the Company's common stock based upon eligible compensation and minimum service requirements. Upon inception of the ESOP, the Company borrowed \$2,000,000 from a bank and lent the proceeds to the trust established under the ESOP to purchase shares of the Company's common stock. The Company's loan to the trust is at an interest rate approximating the prime rate and is repayable to the Company over a 40-year term ending in December 2024. During 1987 and 1988, the Company loaned an additional \$1,942,000 to the trust under terms similar to the Company's original loan. Each year the Company makes contributions to the trust which the plan's trustees use to repay the principal and interest due the Company under the trust loan agreement. Shares held by the trust are allocated in the aggregate to participating employees in proportion to the amount of the loan repayment made by the trust to the Company. Since inception of the ESOP, approximately 392,000 shares have been allocated, exclusive of shares distributed to ESOP participants. At December 31, 2003 and 2002, approximately 445,000 and 470,000 shares, respectively, purchased by the ESOP remain unallocated.

Related compensation expense associated with the Company's ESOP, which is equal to the principal reduction on the loans receivable from the trust, amounted to \$101,000 in 2003 and 2002. Included as a reduction to shareholders' equity is the employee stock ownership trust commitment which represents the remaining indebtedness of the trust to the Company. Employees are entitled to vote allocated shares and the ESOP trustees are entitled to vote unallocated shares and those allocated shares not voted by the employees.

-F11-

#### Defined benefit plan

The Company has noncontributory defined benefit pension plans. Plan benefits are based on stated amounts for each year of service and funding is in accordance with statutory requirements. The Company uses a measurement date of December 1 for its pension plans.

#### WEIGHTED - AVERAGE ASSUMPTIONS

The following table sets forth the weighted-average assumptions used to determine benefit obligations:

|                               | Pension Benefits<br>December 1, |      |
|-------------------------------|---------------------------------|------|
|                               | 2003                            | 2002 |
|                               | ----                            | ---- |
| Discount rate                 | 6.0                             | 6.5  |
| Rate of compensation increase | N/A                             | N/A  |

The following table sets forth the weighted-average assumptions used to

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

determine net periodic benefit cost:

|  | Pension Benefits<br>December 1, |      |
|--|---------------------------------|------|
|  | 2003                            | 2002 |
|  | ----                            | ---- |
| Discount rate                            | 6.5                             | 7.0  |
| Rate of compensation increase            | N/A                             | N/A  |
| Expected long-term return on plan assets | 8.0                             | 8.0  |

PENSION PLAN

The following table sets forth certain information attributable to the Company's employees participation in the Company's pension plans:

|   | Funded Plans<br>December 1, |           |
|---|-----------------------------|-----------|
|   | 2003                        | 2002      |
|   | ----                        | ----      |
| Actuarial present value of benefit obligations: |                             |           |
| Vested benefits                                 | \$421,964                   | \$396,437 |
| Nonvested benefits                              | 7,387                       | 8,137     |
|   | -----                       | -----     |
| Accumulated benefit obligations                 | \$429,351                   | \$404,574 |
|   | =====                       | =====     |
| Projected benefit obligations                   | \$429,351                   | \$404,574 |
|   | =====                       | =====     |

Pension cost allocated to the Company related to the plans was \$25,000 and \$29,000 in 2003 and 2002, respectively. Total anticipated employer contribution for the 2004 plan year is \$51,364.

-F12-

NARRATIVE DESCRIPTION OF DEVELOPMENT OF LONG-TERM RATE OF RETURN

The Company uses historical performance in the market blended with consideration for inflation, risk-free rate of return and risk premium in development of a long-term rate of return.

NARRATIVE DESCRIPTION OF INVESTMENT POLICY STRATEGIES

The Company seeks to maximize income, growth of income, and long-term appreciation and preservation of capital. The assets must be invested with care and diligence with the overriding prudent man rule as a guide to investment management. The Company will, as a general guideline, make occasional disbursements and care should be taken to ensure available funds.

Deferred compensation program

-----

The Company maintains a deferred compensation program designed to achieve, among other things, benefit parity for an officer of the Company. During 2003 and 2002, no amounts were accrued under this program. During 2003, the Company issued treasury stock to satisfy the deferred compensation liability and, as such, there are no amounts accrued on the deferred compensation program at December 31, 2003.

6. Income tax provision (benefit)

-----

The provision (benefit) for income taxes included in the consolidated statement of operations consists of the following:

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

|                              | 2003              | 2002    |
|------------------------------|-------------------|---------|
|                              | ----              | ----    |
|                              | (\$000's omitted) |         |
| Current:                     |                   |         |
| Federal income tax (benefit) | (\$ 37)           | (\$ 5)  |
| State income tax             | 5                 | 9       |
|                              | -----             | -----   |
|                              | (32)              | 4       |
| Deferred:                    |                   |         |
| Federal income tax (benefit) | 177               | (111)   |
| State income tax             | 7                 | 14      |
|                              | -----             | -----   |
|                              | 184               | (97)    |
|                              | -----             | -----   |
|                              | \$ 152            | (\$ 93) |
|                              | =====             | =====   |

-F13-

The reconciliation of the difference between the Company's effective tax rate based upon the total income tax provision (benefit) and the federal statutory income tax rate is as follows:

|  | 2003  | 2002  |
|--|-------|-------|
|  | ----  | ----  |
| Statutory rate                           | 34%   | (34%) |
| Increase resulting from:                 |       |       |
| State income taxes (less federal effect) | 2%    | 5%    |
| Extraterritorial income exclusion        | (3%)  | (3%)  |
| Nondeductible expenses                   | 3%    | 4%    |
| Other                                    | 1%    | (1%)  |
|  | ----- | ----- |
|  | 37%   | (29%) |
|  | ===== | ===== |

At December 31, 2003, the deferred tax assets (liabilities) were comprised of the following:

|   | (\$000's omitted) |       |
|---|-------------------|-------|
| Inventories                                     | \$                | 165   |
| Accrued employee compensation and benefit costs |                   | 195   |
| Operating loss and credit carryforwards         |                   | 138   |
| Minimum pension liability                       |                   | 63    |
| Other   |                   | 8     |
|   |                   | ----- |
| Total deferred tax assets                       |                   | 569   |
| Property, plant and equipment                   |                   | (515) |
| Other liabilities                               |                   | (44)  |
|   |                   | ----- |
| Total deferred tax liabilities                  |                   | (559) |
|   |                   | ----- |
| Net deferred tax asset                          | \$                | 10    |
|   |                   | ===== |

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

Realization of the net deferred tax asset is dependent upon generating sufficient taxable income over the periods in which the temporary differences are anticipated to reverse. Although realization is not assured, management believes it is more likely than not that the net deferred tax asset will be realized. However, the amount of net deferred tax asset considered realizable could be reduced in the near term if estimates of future taxable income are reduced.

At December 31, 2003, the Company has a Federal consolidated net operating loss carryforward of approximately \$80,000 (approximately a \$27,000 tax benefit) which begins to expire in 2022.

At December 31, 2003, the Company also has New York State net operating loss carryforwards of approximately \$992,000 (approximately a \$33,000 net tax benefit) that begin to expire in 2019. The Company also has a State of Pennsylvania net operating loss carryforward of approximately \$1,576,000 (approximately a \$104,000 net tax benefit) that begins to expire in 2006.

-F14-

7. Common shareholders' equity

|  | Common stock |        | Capital in | Retained | ESOP       | Treasury   | Co |
|--|--------------|--------|------------|----------|------------|------------|----|
|  | Number       | Amount | excess of  | earnings |            | stock      | in |
|  | of shares    |        | par value  |          |            |            |    |
|  | issued       |        |            |          |            |            |    |
| (\$000's omitted except share amounts) |              |        |            |          |            |            |    |
| Balance December 31, 2001              | 2,614,506    | \$523  | \$13,361   | \$1,491  | (\$ 2,438) | (\$ 1,054) |    |
| Comprehensive loss:                    |              |        |            |          |            |            |    |
| Net loss                               | -            | -      | -          | (229)    | -          | -          | \$ |
| Other comprehensive loss, net of tax:  |              |        |            |          |            |            |    |
| Minimum pension liability adjustment   | -            | -      | -          | -        | -          | -          |    |
| Other comprehensive loss               | -            | -      | -          | -        | -          | -          |    |
| Comprehensive loss                     | -            | -      | -          | -        | -          | -          | \$ |
| Compensation expense                   | -            | -      | -          | -        | 101        | -          |    |
| Balance December 31, 2002              | 2,614,506    | \$523  | \$13,361   | \$1,262  | (\$ 2,337) | (\$ 1,054) |    |
| Comprehensive income:                  |              |        |            |          |            |            |    |
| Net income                             | -            | -      | -          | 254      | -          | -          | \$ |
| Other comprehensive loss, net of tax:  |              |        |            |          |            |            |    |
| Minimum pension liability adjustment   | -            | -      | -          | -        | -          | -          |    |
| Other comprehensive loss               | -            | -      | -          | -        | -          | -          |    |

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

|   |                  |              |                 |                |                   |                 |
|---|------------------|--------------|-----------------|----------------|-------------------|-----------------|
| Comprehensive income  | -                | -            | -               | -              | -                 | -               |
| Compensation expense  | -                | -            | -               | -              | 101               | -               |
| Treasury shares issued for deferred compensation obligation | -                | -            | (328)           | -              | -                 | 534             |
| Balance December 31, 2003                                   | <u>2,614,506</u> | <u>\$523</u> | <u>\$13,033</u> | <u>\$1,516</u> | <u>(\$ 2,236)</u> | <u>(\$ 520)</u> |

-F15-

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 earnings per share were outstanding for the period.

|  | Year Ended<br>December 31,                 |           |
|--|--|-----------|
|  | 2003                                       | 2002      |
|  | ----                                       | ----      |
|  | (\$000's omitted<br>except per share data) |           |
| Net income (loss)  | \$ 254                                     | \$ (229)  |
| Weighted average common shares outstanding (basic)           | 2,001                                      | 1,898     |
| Incremental shares from assumed conversions of stock options | 10   | 0         |
| Weighted average common shares outstanding (diluted)         | 2,011                                      | 1,898     |
| Basic  |  |           |
| Net income (loss) per share                                  | \$ 0.13                                    | \$ (0.12) |
| Diluted  |  |           |
| Net income (loss) per share                                  | \$ 0.13                                    | \$ (0.12) |

Comprehensive income (loss)

The minimum pension liability adjustment of \$107,000 (\$82,000 - 2002), which is net of taxes amounting to \$63,000 (\$48,000 - 2002), is the only component of other comprehensive income (loss) for 2003.

-F16-

Stock options

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

Under the Servotronics, Inc. 2000 Employee Stock Option Plan authorized by the Board of Directors and the 2001 Long-Term Stock Incentive Plan authorized by the Board of Directors and the Shareholders, and other separate agreements authorized by the Board of Directors, the Company has granted non-qualified options to certain Directors and Officers. The Company applies APB Opinion No. 25 and related interpretations in accounting for these Plans and the separate option agreements. Accordingly, no compensation expense has been charged to earnings in 2003 or prior years as stock options granted have an exercise price equal to the market price on the date of grant. At December 31, 2003, 156,600 shares of common stock were available under these plans. Options granted under these plans have durations of ten years and vesting periods ranging from six (6) months to four (4) years.

A summary of the status of options granted under all employee plans is presented below:

|                                     | Options<br>Outstanding | Weighted<br>Average<br>Exercise<br>Price (\$) |
|-------------------------------------|------------------------|---|
| Outstanding as of December 31, 2001 | 319,200                | 5.37  |
| Granted in 2002                     | -                      | -   |
| Exercised in 2002                   | -                      | -   |
| Forfeited in 2002                   | -                      | -   |
| Outstanding as of December 31, 2002 | 319,200                | 5.37  |
| Granted in 2003                     | 145,000                | 2.045   |
| Exercised in 2003                   | -                      | -   |
| Forfeited in 2003                   | -                      | -   |
| Outstanding as of December 31, 2003 | 464,200                | 4.01  |

The following tables summarize information about options outstanding at December 31, 2003:

| Exercise<br>Prices (\$) | Number<br>Outstanding | Remaining<br>Contractual<br>Life | Options<br>Exercisable |
|-------------------------|-----------------------|----------------------------------|------------------------|
| 8.50                    | 93,000                | 4 years                          | 93,000                 |
| 3.8125                  | 101,200               | 7 years                          | 101,200                |
| 4.38                    | 125,000               | 8 years                          | 117,000                |
| 2.045                   | 145,000               | 10 years                         | 122,000                |
|                         | -----                 |                                  | -----                  |
| Total                   | 464,200               |                                  | 433,200                |
|                         | =====                 |                                  | =====                  |

The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation". If the compensation cost for

-F17-

these plans had been determined based on the Black-Scholes calculated values at the grant dates for awards consistent with the method prescribed by SFAS No. 123, the pro forma effects on the years ended December 31, 2003 and 2002 are as follows:

|      |      |
|------|------|
| 2003 | 2002 |
| ---- | ---- |



## Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

|                                   |           |             |
|-----------------------------------|-----------|-------------|
| Net income (loss):                |           |             |
| As reported                       | \$254,000 | \$(229,000) |
| Pro forma                         | \$128,000 | \$(406,000) |
| Earnings (loss) per common share: |           |             |
| As reported - basic               | \$0.13    | \$(0.12)    |
| As reported - diluted             | \$0.13    | \$(0.12)    |
| Pro forma - basic                 | \$0.06    | \$(0.21)    |
| Pro forma - diluted               | \$0.06    | \$(0.21)    |

There were 145,000 options granted in 2003. The Black-Scholes calculated estimated value of the options granted in 2003 was \$1.277. The assumptions used to calculate this value include a risk-free interest rate of 3.83%, an expected term of 10 years, and an annual standard deviation (volatility) factor of 46.6%. The Black-Scholes option pricing model was developed for use in estimating values of traded options that have no vesting restrictions and are fully transferable. In addition, option pricing models require the use of highly subjective assumptions, including the expected stock price volatility. Because the Company's stock options are restricted and have characteristics significantly different from those of traded options, and because changes in the subjective assumptions can materially affect the calculated estimated values, in the Company's opinion the existing models do not necessarily provide a reliable measure of the value of the Company's stock options. The estimated value calculated by the Black-Scholes methodology is hypothetical and does not represent an actual tangible Company expense or an actual tangible monetary transfer to the optionee. Further, for the reasons stated above (among others) and especially because of the volatility factor used in the Black-Scholes calculations for the Company's 2003 options, the derived estimated value may be, in the Company's opinion, substantially higher than the value which may be realized in an arms-length transaction under the above stated and existing conditions.

-F18-

### Shareholders' rights plan

-----

During 2002, the Company's Board of Directors adopted a shareholders' rights plan (the "Rights Plan") and simultaneously declared a dividend distribution of one Right for each outstanding share of the Company's common stock outstanding at August 28, 2002. The Rights Plan replaced a previous shareholder right plan that was adopted in 1992 and expired on August 28, 2002. The Rights do not become exercisable until the earlier of (i) the date of the Company's public announcement that a person or affiliated group other than Dr. Nicholas D. Trbovich or the ESOP trust (an "Acquiring Person") has acquired, or obtained the right to acquire, beneficial ownership of 25% or more of the Company's common stock (excluding shares held by the ESOP trust) or (ii) ten business days following the commencement of a tender offer that would result in a person or affiliated group becoming an Acquiring Person.

The exercise price of a Right has been established at \$32.00. Once exercisable, each Right would entitle the holder to purchase one one-hundredth of a share of Series A Junior Participating Preferred Stock. In the event that any person becomes an Acquiring Person, each Right would entitle any holder other than the Acquiring Person to purchase common stock or other securities of the Company having a value equal to three times the exercise price. The Board of Directors has the discretion in such event to exchange two shares of common stock or two one-hundredths of a share of preferred stock for each Right held by any holder other than the Acquiring Person.

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

8. Commitments  
-----

The Company leases certain equipment pursuant to operating lease arrangements. Total rental expense in 2003 and 2002 and future minimum payments under such leases are not significant.

9. Litigation  
-----

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.

10. Business segments  
-----

The Company operates in two business segments, the Advanced Technology Group and the Consumer Products Group. The Company's reportable segments are strategic business units that offer different products and services. The segments are composed of separate corporations and are managed separately. Operations in the Advanced Technology Group involve the design, manufacture, and marketing of servo-control components for government and commercial applications. The Consumer Products Group's operations involve the design, manufacture and marketing of a variety of cutlery products for use by consumers and government agencies. The Company derives its primary sales revenue from domestic customers, although a portion of finished products are for foreign use.

-F19-

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

| Year ended<br>December 31, 2003<br>----- | Advanced<br>Technology<br>Group<br>----- | Consumer<br>Products<br>Group<br>----- | Consolidat<br>----- |
|--|--|--|---------------------|
|  |  | (\$000's omitted)                      |                     |
| Revenues from unaffiliated customers     | \$ 10,289                                | \$ 7,285                               | \$ 17               |
|  | =====                                    | =====                                  | =====               |
| Profit                                   | \$ 1,561                                 | \$ 203                                 | 1                   |
|  | =====                                    | =====                                  | =====               |
| Depreciation and amortization            | \$ (522)                                 | \$ (147)                               |                     |
|  | =====                                    | =====                                  |                     |
| Interest expense                         |  |  |                     |
| General corporate expense                |  |  |                     |
|  |  |  | -----               |
| Income before income taxes               |  |  | \$                  |
|  |  |  | =====               |
| Identifiable assets                      | \$ 13,920                                | \$ 6,021                               | \$ 19               |
|  | =====                                    | =====                                  | =====               |
| Capital expenditures                     | \$ 53                                    | \$ 95                                  | \$                  |

Edgar Filing: SERVOTRONICS INC /DE/ - Form 10KSB

| Year ended<br>December 31, 2002<br>----- | Advanced<br>Technology<br>Group<br>----- | Consumer<br>Products<br>Group<br>-----<br>(\$000's omitted) | Consolidat<br>----- |
|--|--|---|---------------------|
| Revenues from unaffiliated customers     | \$ 10,213                                | \$ 5,394  | \$ 15               |
| Profit (loss)                            | \$ 1,080                                 | \$ (41)   | 1                   |
| Depreciation expense                     | \$ (506)                                 | \$ (154)  |                     |
| Interest expense                         |  |   |                     |
| General corporate expense                |  |   |                     |
| Loss before income taxes                 |  |   | \$                  |
| Identifiable assets                      | \$ 14,521                                | \$ 5,208  | \$ 19               |
| Capital expenditures                     | \$ 326                                   | \$ 391  | \$                  |

-F20-

The Company engages in a significant amount of business with the United States Government through sales to its prime contractors and otherwise. Such contracts by the Advanced Technology Group accounted for revenues of approximately \$5,200,000 in 2003 and \$3,400,000 in 2002. Similar contracts by the Consumer Products Group accounted for revenues of approximately \$2,100,000 in 2003 and \$190,000 in 2002. Sales of advanced technology products to one prime contractor, including various divisions and subsidiaries of a common parent company, amounted to approximately 14% and 18% of total revenues in 2003 and 2002, respectively. The Company also had sales to another customer that amounted to approximately 17% and 21% of total revenues in 2003 and 2002, respectively. Another prime contractor provided sales of approximately 13% and 6% of total revenues in 2003 and 2002. No other single customer represented more than 10% of the Company's revenues in any of these years.

-F21-