

SERVOTRONICS INC /DE/
Form 10-Q
November 12, 2013

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

(Mark One)

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

For the quarterly period ended September 30, 2013

or

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

Commission File No. 1-07109
SERVOTRONICS, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

16-0837866
(I. R. S. Employer
Identification No.)

1110 Maple Street
Elma, New York 14059
(Address of principal executive offices) (zip code)
(716) 655-5990

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

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| Class | Outstanding at October 31, 2013 |
|-------------------------------|---------------------------------|
| Common Stock, \$.20 par value | 2,494,043 |

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

| | September 30, 2013 (Unaudited) | December 31, 2012 |
|---|---|-------------------------|
| Current assets: | | |
| Cash and cash equivalents | \$4,998 | \$5,573 |
| Accounts receivable, net | 5,438 | 4,858 |
| Inventories, net | 11,933 | 11,213 |
| Prepaid income taxes | 19 | 387 |
| Deferred income taxes | 655 | 655 |
| Other assets | 563 | 306 |
| Total current assets | 23,606 | 22,992 |
| Property, plant and equipment, net | 6,588 | 5,946 |
| Other non-current assets | 351 | 365 |
| Total Assets | \$ 30,545 | \$ 29,303 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 192 | \$ 192 |
| Accounts payable | 1,463 | 1,051 |
| Accrued employee compensation and benefit costs | 1,863 | 1,422 |
| Other accrued liabilities | 275 | 389 |
| Total current liabilities | 3,793 | 3,054 |
| Long-term debt | 2,647 | 2,663 |
| Deferred income taxes | 320 | 320 |
| Commitments and contingencies (See Note 10) | - | - |
| Shareholders' equity: | | |
| Common stock, par value \$.20; authorized 4,000,000 shares; issued 2,614,506 shares; outstanding 2,293,614 (2,157,920 - 2012) shares | 523 | 523 |
| Capital in excess of par value | 14,008 | 13,987 |
| Retained earnings | 12,366 | 11,771 |
| Accumulated other comprehensive loss | (85) | (85) |
| Employee stock ownership trust commitment | (1,165) | (1,165) |

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| | | |
|---|-----------|-----------|
| Treasury stock, at cost 105,678 (241,372 - 2012) shares | (1,862) | (1,765) |
| Total shareholders' equity | 23,785 | 23,266 |
| Total Liabilities and Shareholders' Equity | \$ 30,545 | \$ 29,303 |

See notes to consolidated financial statements

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|----------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenue | \$7,727 | \$7,516 | \$23,136 | \$23,302 |
| Costs, expenses and other income: | | | | |
| Cost of goods sold, exclusive of depreciation and amortization | 5,594 | 5,536 | 17,164 | 17,081 |
| Selling, general and administrative | 1,506 | 1,275 | 4,140 | 3,753 |
| Interest expense | 10 | 11 | 31 | 34 |
| Depreciation and amortization | 152 | 141 | 460 | 437 |
| Other income, net | (44) | (2) | (45) | (12) |
| Total expenses | 7,218 | 6,961 | 21,750 | 21,293 |
| Income from continuing operations before income tax provision | 509 | 555 | 1,386 | 2,009 |
| Income tax provision | 151 | 249 | 347 | 663 |
| Income from continuing operations | 358 | 306 | 1,039 | 1,346 |
| Discontinued Operations: | | | | |
| Loss from operations of a discontinued component, net of income tax benefit | - | (188) | - | (591) |
| Loss on disposal of QCC and AMP, net of income tax benefit | - | (262) | - | (530) |
| Loss from discontinued operations | - | (450) | - | (1,121) |
| Net income (loss) | \$358 | \$(144) | \$1,039 | \$225 |
| Income (loss) per share: | | | | |
| Basic | | | | |
| Income per share from continuing operations | \$0.16 | \$0.14 | \$0.46 | \$0.63 |
| Loss per share from discontinued operations | - | (0.21) | - | (0.53) |
| Total net income (loss) per share | \$0.16 | \$(0.07) | \$0.46 | \$0.10 |
| Diluted | | | | |
| Income per share from continuing operations | \$0.16 | \$0.14 | \$0.46 | \$0.63 |
| Loss per share from discontinued operations | - | (0.21) | - | (0.52) |
| Total net income (loss) per share | \$0.16 | \$(0.07) | \$0.46 | \$0.11 |

See notes to consolidated financial statements

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------------------|-------------------------------------|---------|------------------------------------|-------|
| | 2013 | 2012 | 2013 | 2012 |
| Net income (loss) | \$358 | \$(144) |) \$1,039 | \$225 |
| Other comprehensive income: | | | | |
| Retirement benefits adjustment | - | - | - | - |
| Total comprehensive income (loss) | \$358 | \$(144) |) \$1,039 | \$225 |

See notes to consolidated financial statements

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

| | Nine Months Ended September 30, | |
|--|------------------------------------|-------------|
| | 2013 | 2012 |
| Cash flows related to operating activities: | | |
| Net income | \$1,039 | \$225 |
| Adjustments to reconcile net income to net cash generated in operating activities: | | |
| Depreciation and amortization | 460 | 484 |
| Loss on disposal of QCC and AMP, net of income tax benefit | - | 530 |
| Stock based compensation | 165 | - |
| (Decrease) increase in inventory reserve | (45) |) 59 |
| (Decrease) increase in allowance for doubtful accounts | (27) |) 33 |
| Gain on disposal of property and equipment | (22) |) (9) |
| Change in assets and liabilities: | | |
| Accounts receivable | (553) |) 636 |
| Inventories | (675) |) (1,106) |
| Prepaid income taxes | 389 | 101 |
| Other assets | (257) |) (222) |
| Other non-current assets | 14 | (24) |
| Accounts payable | 412 | (446) |
| Accrued employee compensation and benefit costs | 443 | 196 |
| Other accrued liabilities | (114) |) 152 |
| Net cash generated from operating activities | 1,229 | 609 |
| Cash flows related to investing activities: | | |
| Capital expenditures - property, plant and equipment | (1,124) |) (394) |
| Proceeds from the sale of Queen Cutlery | - | 640 |
| Proceeds from sale of assets | 43 | - |
| Net cash (used) generated from investing activities | (1,081) |) 246 |
| Cash flows related to financing activities: | | |
| Principal payments on long-term debt | (16) |) (29) |
| Proceeds from exercise of stock options | 70 | 234 |
| Principal payments on capital lease related party | - | (41) |
| Purchase of treasury shares | (371) |) (62) |
| Cash dividend | (406) |) (358) |
| Net cash used in financing activities | (723) |) (256) |
| Net (decrease) increase in cash and cash equivalents | (575) |) 599 |
| Cash and cash equivalents at beginning of period | 5,573 | 4,948 |

| | | |
|--|---------|---------|
| Cash and cash equivalents at end of period | \$4,998 | \$5,547 |
|--|---------|---------|

See notes to consolidated financial statements

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SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

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

The accompanying consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. All such adjustments are of a normal recurring nature. Operating results for the three and nine months ended September 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. The consolidated financial statements should be read in conjunction with the 2012 annual report and the notes thereto.

2. Business Description and Summary of Significant Accounting Policies

Business Description

Servotronics, Inc. and its subsidiaries design, manufacture and market advanced technology products consisting primarily of control components and consumer products consisting of knives and various types of cutlery and other edged products.

Principles of Consolidation

The consolidated financial statements include the accounts of Servotronics, Inc. and its wholly-owned subsidiaries (the "Company"). All intercompany balances and transactions have been eliminated upon consolidation.

Cash and Cash Equivalents

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

Accounts Receivable

The Company grants credit to substantially all of its customers and carries its accounts receivable at original invoice amount less an allowance for doubtful accounts. On a periodic basis, the Company evaluates its accounts receivable and establishes an allowance for doubtful accounts based on history of past write-offs, collections, and current credit conditions. The allowance for doubtful accounts amounted to approximately \$103,000 at September 30, 2013 and \$130,000 at December 31, 2012. The Company does not accrue interest on past due receivables.

Revenue Recognition

Revenues are recognized as services are rendered or as units are shipped and at the designated FOB point consistent with the transfer of title, risks and rewards of ownership. Such purchase orders generally include specific terms relative to quantity, item description, specifications, price, customer responsibility for in-process costs, delivery

schedule, shipping point, payment and other standard terms and conditions of purchase.

Inventories

Inventories are stated at the lower of standard cost or net realizable value. Cost includes all costs incurred to bring each product to its present location and condition. Market provisions in respect of lower of cost or market adjustments and inventory expected to be used in greater than one year are applied to the gross value of the inventory through a reserve of approximately \$733,000 and \$778,000 at September 30, 2013 and December 31, 2012, respectively. Pre-production and start-up costs are expensed as incurred.

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SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The purchase of suppliers' minimum economic quantities of material such as steel, etc. may result in a purchase of quantities exceeding one year of customer requirements. Also, in order to maintain a reasonable and/or agreed to lead time, certain larger quantities of other product support items may have to be purchased and may result in over one year's supply.

Shipping and Handling Costs

Shipping and handling costs are classified as a component of cost of goods sold.

Property, Plant and Equipment

Property, plant and equipment is carried at cost; expenditures for new facilities and equipment and expenditures which substantially increase the useful lives of existing plant and equipment are capitalized; expenditures for maintenance and repairs are expensed as incurred. Upon disposal of properties, the related cost and accumulated depreciation are removed from the respective accounts and any profit or loss on disposition is included in income.

Depreciation is provided on the basis of estimated useful lives of depreciable properties, primarily by the straight-line method for financial statement purposes and by accelerated methods for tax purposes. Depreciation expense includes the amortization of capital lease assets. The estimated useful lives of depreciable properties are generally as follows:

| | |
|----------------------------|------------|
| Buildings and improvements | 5-39 years |
| Machinery and equipment | 5-20 years |
| Tooling | 3-5 years |

Income Taxes

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of operating loss and credit carryforwards and temporary differences between the carrying amounts and the tax basis of assets and liabilities. The Company and its subsidiaries file a consolidated federal income tax return, combined New York and Texas state income tax returns and separate Pennsylvania and Arkansas state income tax returns.

The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company did not have any accrued interest or penalties included in its consolidated balance sheets at September 30, 2013 or December 31, 2012, and did not recognize any interest and/or penalties in its consolidated statements of income during the three and nine months ended September 30, 2013 and 2012.

The 2010 through 2012 Federal and state returns remain open under statute.

Supplemental Cash Flow Information

Income taxes paid during the three months ended September 30, 2013 and 2012 amounted to approximately \$136,000 and zero, respectively, and amounted to approximately \$136,000 and \$256,000 for the nine months ended September 30, 2013 and 2012, respectively. Interest paid during the three months ended September 30, 2013 and 2012 amounted to approximately \$10,000 and \$12,000, respectively, and amounted to \$31,000 and \$38,000 for the nine months ended September 30, 2013 and 2012, respectively. In the first quarter of 2013, the Company reduced its tax liability by approximately \$21,000 related to the exercise of stock options and was credited directly to capital in excess of par value.

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SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Employee Stock Ownership Plan

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

Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in business circumstances indicate, or at least annually, that the carrying amount of the assets may not be fully recoverable based on undiscounted future operating cash flow analyses. If an impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal. The Company has determined that no impairment of long-lived assets existed at September 30, 2013 and December 31, 2012.

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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain balances as previously reported were reclassified to conform with classifications adopted in the current period.

Research and Development Costs

Research and development costs are expensed as incurred.

Concentration of Credit Risks

Financial instruments that potentially subject the Company to concentration of credit risks principally consist of cash accounts in financial institutions. Although the accounts exceed the federally insured deposit amount, management does not anticipate nonperformance by the financial institutions. Refer to Note 12, Business Segments, for disclosures related to customer concentrations.

Fair Value of Financial Instruments

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

3.

Discontinued Operations

During the second quarter of 2012, the Company committed to a plan to enhance profit margins through the expected sale of a component. On September 18, 2012, Queen Cutlery Company (QCC), a wholly owned subsidiary of Servotronics Inc., completed the disposition of substantially all of its assets for cash consideration of \$650,000. QCC is accounted for as a discontinued operation in the accompanying consolidated financial statements. During the three and nine months ended September 30, 2013 there was no loss from discontinued operations related to QCC. A loss before income taxes of approximately \$116,000 and \$358,000 from discontinued operations was reported for the same three and nine month periods in 2012.

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SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On July 23, 2012, Aero Metal Products, Inc. (“AMP”), a wholly owned subsidiary of Servotronics, Inc., gave notice of termination of a personal property capital lease for machinery and equipment previously reported under a \$588,000 capital lease with a related party. Due to the termination, beginning in July 2012, this lease is accounted for as an operating lease rather than a capital lease for the remaining term and the related assets and liabilities were removed from the consolidated balance sheet. In the third quarter of 2012, AMP ceased all manufacturing operations and in the fourth quarter of 2012, the Company surrendered all assets under the personal property and real property lease to the lessor, Aero Inc., a previously reported related party. During the three and nine months ended September 30, 2013, there was no loss from discontinued operations related to AMP. A loss before income taxes of approximately \$169,000 and \$537,000 from discontinued operations was reported for the same three and nine month periods in 2012.

The following is a summary of discontinued operations:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|-------------|
| | 2013 | 2012 | 2013 | 2012 |
| | (\$000's omitted) | | | |
| Discontinued operations: | | | | |
| Revenue of QCC and AMP | \$ - | \$ 221 | \$ - | \$ 899 |
| Loss from operations of QCC and AMP | \$ - | \$ (285) | \$ - | \$ (895) |
| Income tax benefit | - | 97 | - | 304 |
| Net loss from operations of QCC and AMP | - | (188) | - | (591) |
| Loss on disposal of QCC and AMP | - | (397) | - | (804) |
| Income tax benefit | - | 135 | - | 274 |
| Net loss on disposal of QCC and AMP | - | (262) | - | (530) |
| Loss from discontinued operations | \$ - | \$ (450) | \$ - | \$ (1,121) |

4. Inventories

| | September 30, 2013 | December 31, 2012 |
|-----------------------------------|--------------------------|----------------------|
| | (\$000's omitted) | |
| Raw materials and common parts | \$ 6,160 | \$ 6,189 |
| Work-in-process | 3,258 | 2,460 |
| Finished goods | 2,515 | 2,564 |
| Total inventories, net of reserve | \$ 11,933 | \$ 11,213 |

5. Property, Plant and Equipment

| | September 30, 2013 | December 31, 2012 |
|--|--------------------------|----------------------|
| | (\$000's omitted) | |
| Land | \$ 21 | \$ 21 |
| Buildings | 7,876 | 7,256 |
| Machinery, equipment and tooling | 12,794 | 12,370 |
| | 20,691 | 19,647 |
| Less accumulated depreciation and amortization | (14,103) | (13,701) |
| Total property, plant and equipment | \$ 6,588 | \$ 5,946 |

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SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Property, plant and equipment includes land and building in Elma, New York, under a \$5,000,000 capital lease which can be purchased for a nominal amount at the end of the lease term. As of September 30, 2013 and December 31, 2012, accumulated amortization on the building amounted to approximately \$2,649,000 and \$2,552,000, respectively. Amortization expense amounted to \$32,000 and \$33,000 for the three month periods ended September 30, 2013 and 2012, respectively, and amounted to \$97,000 for the nine month periods ended September 30, 2013 and 2012, respectively. The associated current and long-term liabilities are discussed in Note 6, Long-Term Debt, of the accompanying consolidated financial statements.

On July 23, 2012, the Company gave notice of termination of a capital lease for machinery and equipment previously reported under a \$588,000 capital lease with a related party. Due to the termination, beginning in July 2012, this lease was accounted for as an operating lease rather than a capital lease for the remaining term and the related assets and liabilities were removed from the consolidated balance sheet. See also, Note 7, Capital Lease – Related Party, of the accompanying consolidated financial statements for more information. Amortization expense related to the capital lease related party, included in the loss from operations of a discontinued component, net of tax, amounted to zero for the three month periods ended September 30, 2013 and 2012, respectively, and amounted to approximately zero and \$42,000 for the nine month periods ended September 30, 2013 and 2012, respectively.

Depreciation expense from continuing operations amounted to \$117,000 and \$107,000 for the three month periods ended September 30, 2013 and 2012, respectively, and amounted to \$355,000 and \$334,000 for the nine month periods ended September 30, 2013 and 2012, respectively. The combined depreciation and amortization expense from continuing operations amounted to \$152,000 and \$141,000 for the three month periods ended September 30, 2013 and 2012, respectively, and amounted to \$460,000 and \$437,000 for the nine month periods ended September 30, 2013 and 2012, respectively. The Company believes that it maintains property and casualty insurance in amounts adequate for the risk and nature of its assets and operations and which are generally customary in its industry.

As of September 30, 2013, there is approximately \$121,000 of construction in progress included in property, plant and equipment related to an anticipated facility expansion and renovation project at the Consumer Products Group. There are currently no other material commitments for this project. At December 31, 2012 there was approximately \$290,000 of construction in progress related to a previously reported facility expansion at the Company's Advanced Technology Group. These amounts along with amounts incurred during 2013 were placed in service in the third quarter ended September 30, 2013.

6. Long-Term Debt

| September 30, 2013 | December 31, 2012 |
|--------------------------|----------------------|
| (\$000's omitted) | |

| | | |
|---|-------|----------|
| Industrial Development Revenue Bonds; secured by an equivalent letter of credit from a bank with interest payable monthly at a floating rate (0.32% at September 30, 2013) (A) \$ | 2,790 | \$ 2,790 |
|---|-------|----------|

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| | | |
|---|----------|----------|
| Secured term loan payable to a government agency; monthly payments of \$1,950 including interest fixed at 3% payable through fourth quarter of 2015 | 49 | 65 |
| | 2,839 | 2,855 |
| Less current portion | (192) | (192) |
| | \$ 2,647 | \$ 2,663 |

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SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(A) The Industrial Development Revenue Bonds were issued by a government agency to finance the construction of the Company's headquarters/advanced technology facility. Annual sinking fund payments of \$170,000 commenced December 1, 2000 and continue through 2013, with a final payment of \$2,620,000 due December 1, 2014. The Company has agreed to reimburse the issuer of the letter of credit if there are draws on that letter of credit. The Company pays the letter of credit bank an annual fee of 1% of the amount secured thereby and pays the remarketing agent for the bonds an annual fee of 1/4% of the principal amount outstanding. The Company's interest under the facility capital lease has been pledged to secure its obligations to the government agency, the bank and the bondholders.

The Company has an unsecured \$2,000,000 line of credit on which there was no balance outstanding at September 30, 2013 or December 31, 2012.

Certain lenders require the Company to comply with debt covenants as described in the specific loan documents, including a debt service ratio. At September 30, 2013 and December 31, 2012, the Company was in compliance with its debt covenants.

7. Capital Lease – Related Party

On November 3, 2009, the Company entered into a capital lease with a related party (Aero, Inc.) of the Company for certain personal property. Monthly payments of \$7,500 which include an imputed fixed interest rate of 2.00% commenced November 3, 2009 through the fourth quarter of 2016.

On July 23, 2012, the Company gave twelve months notice of termination of this lease. There was no material gain or loss associated with the cancellation of such agreement. Due to the termination, beginning in July 2012, this lease was accounted for as an operating lease rather than a capital lease for the remaining term and the related assets and liabilities were removed from the consolidated balance sheet. The Company has accrued for the remaining balances payable on the accompanying September 30, 2013 consolidated financial statements, see Note 10, Commitments and Contingencies, regarding pending litigation related to the lease termination. The termination relates to discontinued operations as discussed in Note 3, Discontinued Operations, of the accompanying consolidated financial statements. There are no other future obligations under this lease.

8. Income Taxes

The Company did not have any material uncertain tax positions or unrecognized tax benefits or obligations as of September 30, 2013 and December 31, 2012. The Company recorded a tax benefit of approximately \$40,000 in the first quarter of 2013 to reflect the research and development tax credit re-enactment related to fiscal 2012. The Company and its subsidiaries file a consolidated federal income tax return, combined New York and Texas state income tax returns and separate Pennsylvania and Arkansas state income tax returns.

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| 9. Shareholders' Equity | | | | | | | | |
|--|-------------------------------|--------|---|----------------------|------------|-------------------|---|----------------------------------|
| (\$000's omitted except for share data) | | | | | | | | |
| | Common stock | | Capital in excess of par value | Retained earnings | ESOP | Treasury Stock | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
| | Number of shares issued | Amount | | | | | | |
| Balance December 31, 2012 | 2,614,506 | \$ 523 | \$ 13,987 | \$ 11,771 | \$ (1,165) | \$ (1,765) | \$ (85) | \$ 23,266 |
| Net income | - | - | - | 1,039 | - | - | - | 1,039 |
| Purchase of treasury shares | - | - | - | - | - | (371) | - | (371) |
| Cash dividend | - | - | - | (406) | - | - | - | (406) |
| Stock based compensation | - | - | - | - | - | 165 | - | 165 |
| Exercise of stock options, net of tax benefit | - | - | 21 | (38) | - | 109 | - | 92 |
| Balance September 30, 2013 | 2,614,506 | \$ 523 | \$ 14,008 | \$ 12,366 | \$ (1,165) | \$ (1,862) | \$ (85) | \$ 23,785 |

In January 2006, the Board of Directors authorized the purchase of up to 250,000 shares of the Company's outstanding common stock in the open market or in privately negotiated transactions. On October 31, 2008, the Company announced that its Board of Directors authorized the purchase of an additional 200,000 shares of the Company's common stock under the Company's current purchase program. As of September 30, 2013, the Company has purchased 296,131 shares and there remain 153,869 shares available to purchase under this program. There were 44,306 shares purchased by the Company during the nine month period ended September 30, 2013. Subsequent to quarter end there were 14,785 shares purchased by the Company through October 31, 2013 for approximately \$130,000.

In the first quarter of 2013 certain option holders elected to exercise 15,000 options. These shares were issued out of treasury stock for net proceeds of approximately \$70,000. Such transactions were properly reported on Form 4 with the Securities and Exchange Commission. A tax benefit to the Company of approximately \$21,000 associated with these transactions reduced taxes payable and was credited directly to capital in excess of par value.

On April 18, 2013, the Company issued 165,000 shares of restricted stock to Executive Officers of the Company under the Company's 2012 Long-Term Incentive Plan that was approved by the shareholders at the 2012 Annual Meeting of Shareholders. The restricted share awards vest over four year periods between January 2014 and January 2017; however, have voting rights and accrue dividends prior to vesting. The aggregate amount of expense to the

Company, measured based on grant date fair value is expected to be \$1,336,500 and will be recognized over the four year requisite service period. Included in the three and nine months ended September 30, 2013 is \$90,000 and \$165,000, respectively, of compensation expense related to the restrictive share awards.

On May 28, 2013 the Company announced that its Board of Directors declared a \$0.16 per share cash dividend. The dividend was subsequently paid on July 15, 2013 to shareholders of record on June 24, 2013 and was approximately \$406,000 in the aggregate. These dividends do not represent that the Company will pay dividends on a regular or scheduled basis.

Earnings Per Share

Basic earnings per share is computed by dividing net earnings by the weighted average number of shares outstanding during the period. Diluted earnings per share is computed by dividing net earnings by the weighted average number of shares outstanding during the period plus the number of shares of common stock that would be issued assuming all contingently issuable shares having a dilutive effect on the earnings per share that were outstanding for the period. Incremental shares from assumed conversions are calculated as the number of shares that would be issued, net of the number of shares that could be purchased in the marketplace with the cash received upon stock option exercise.

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|------------|------------------------------------|----------|
| | 2013 | 2012 | 2013 | 2012 |
| | (\$000's omitted except per share data) | | | |
| Income from continuing operations | \$ 358 | \$ 306 | \$ 1,039 | \$ 1,346 |
| Loss from discontinued operations | - | (450) | - | (1,121) |
| Net income (loss) | \$ 358 | \$ (144) | \$ 1,039 | \$ 225 |
| Weighted average common shares outstanding (basic) | 2,305 | 2,146 | 2,259 | 2,125 |
| Incremental shares from assumed conversions of stock options | - | 6 | 1 | 19 |
| Weighted average common shares outstanding (diluted) | 2,305 | 2,152 | 2,260 | 2,144 |
| Basic | | | | |
| Income per share from continuing operations | \$ 0.16 | \$ 0.14 | \$ 0.46 | \$ 0.63 |
| Loss per share from discontinued operations | - | (0.21) | - | (0.53) |
| Total net income (loss) per share | \$ 0.16 | \$ (0.07) | \$ 0.46 | \$ 0.10 |
| Diluted | | | | |
| Income per share from continuing operations | \$ 0.16 | \$ 0.14 | \$ 0.46 | \$ 0.63 |
| Loss per share from discontinued operations | - | (0.21) | - | (0.52) |
| Total net income (loss) per share | \$ 0.16 | \$ (0.07) | \$ 0.46 | \$ 0.11 |

10. Commitments and Contingencies

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

additional liability has been accrued as of September 30, 2013 or December 31, 2012 related to these items since the likelihood, if any, cannot be determined or reliably measured at this time.

The Company has pending litigation relative to leases of certain equipment and real property with a former related party, Aero Inc. (see Note 7, Capital Lease – Related Party, and Note 11, Related Party Transactions). Aero Inc. is suing Servotronics, Inc. and its wholly owned subsidiary and has alleged damages in the amount of \$3,000,000. The Company has filed a response to the Aero, Inc. lawsuit and has also filed a counter-claim in the amount of \$3,191,000. The Company has not considered the risk of loss to be probable, but is unable to reasonably or accurately estimate the likelihood and amount of any liability or benefit that may be realized as a result of this litigation.

The Company leases certain equipment pursuant to operating lease arrangements. Total rental expense in the three and nine month periods ended September 30, 2013 and 2012 and future minimum payments under such leases are not material to the consolidated financial statements. The Company also leases certain real property being accounted for under capital leases. See also Note 5, Property, Plant and Equipment, Note 6, Long-Term Debt, Note 7, Capital Lease – Related Party and Note 11, Related Party Transactions of the accompanying consolidated financial statements for information on the leases.

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company anticipates a multi-year investment plan designed to consolidate the operations of the CPG. The five year plan includes the construction of an approximate 25,000 square foot addition, capital improvements to the existing plant, the reconfiguration of its production process within the expanded facility, and the addition of new state of the art knife-making equipment. The timing, nature and extent of the expansion and renovation project are dependent upon the ability of the Company to secure financial assistance from various governmental assistance programs that it has applied for. At this time there are no material commitments of financial resources.

11. Related Party Transactions

During 2009 the Company formed a new wholly owned subsidiary (Aero Metal Products, Inc.) that leased certain personal property from a related party through the execution of a capital lease. The Company also entered into a real property operating lease agreement, with the same related party, which provided for annual rental payments of \$60,000. These transactions were disclosed as related party transactions because the wife of a former officer of Servotronics, Inc. is a sole shareholder of the company that was leasing/selling the assets. In connection with the Company's decision to cease all manufacturing operations in the third quarter of 2012 at this subsidiary, and the subsequent surrender of assets under the personal property and real property leases to the related party in the fourth quarter of 2012, the Company accrued for the remaining lease payments which are not material to the September 30, 2013 consolidated financial statements. See Note 7, Capital Lease-Related Party and Note 10, Commitments and Contingencies, of the accompanying consolidated financial statements.

12. Business Segments

The Company operates in two business segments, Advanced Technology Group ("ATG") and Consumer Products Group ("CPG"). The Company's reportable segments are strategic business units that offer different products and services. The segments are composed of separate corporations and are managed separately. Operations in ATG primarily involve the design, manufacture, and marketing of servo-control components (i.e., torque motors, control valves, actuators, etc.) for government, commercial and industrial applications. CPG's operations involve the design, manufacture and marketing of a variety of cutlery 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 end use.

As of September 30, 2013, the Company had identifiable assets of approximately \$30,545,000 (\$29,303,000 – December 31, 2012) of which approximately \$19,986,000 (\$19,211,000 – December 31, 2012) was for ATG and approximately \$10,559,000 (\$10,092,000 – December 31, 2012) was for CPG.

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

| | ATG | | CPG | | Consolidated | |
|---|-------------------|-----------|-------------------|------------|-------------------|-----------|
| | Nine Months Ended | | Nine Months Ended | | Nine Months Ended | |
| | September 30, | | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| Revenues from unaffiliated customers | \$ 16,709 | \$ 16,671 | \$ 6,427 | \$ 6,631 | \$ 23,136 | \$ 23,302 |
| Cost of goods sold, exclusive of depreciation and amortization | (11,978) | (11,445) | (5,186) | (5,636) | (17,164) | (17,081) |
| Selling, general and administrative | (2,886) | (2,411) | (1,254) | (1,342) | (4,140) | (3,753) |
| Interest expense | (31) | (34) | - | - | (31) | (34) |
| Depreciation and amortization | (328) | (323) | (132) | (114) | (460) | (437) |
| Other income, net | 1 | 5 | 44 | 7 | 45 | 12 |
| Income (loss) from continuing operations before income tax provision | 1,487 | 2,463 | (101) | (454) | 1,386 | 2,009 |
| Income tax provision (benefit) | 375 | 812 | (28) | (149) | 347 | 663 |
| Income (loss) from continuing operations | 1,112 | 1,651 | (73) | (305) | 1,039 | 1,346 |
| Discontinued operations: | | | | | | |
| Loss from operations of a discontinued component, net of income tax benefit | - | - | - | (591) | - | (591) |
| Loss on disposal of QCC and AMP, net of income tax benefit | - | - | - | (530) | - | (530) |
| Loss from discontinued operations | - | - | - | (1,121) | - | (1,121) |
| Net income (loss) | \$ 1,112 | \$ 1,651 | \$ (73) | \$ (1,426) | \$ 1,039 | \$ 225 |
| Capital expenditures | \$ 920 | \$ 327 | \$ 204 | \$ 67 | \$ 1,124 | \$ 394 |

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| | ATG | | CPG | | Consolidated | |
|---|--------------------|----------|--------------------|-----------|--------------------|-----------|
| | Three Months Ended | | Three Months Ended | | Three Months Ended | |
| | September 30, | | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| Revenues from unaffiliated customers | \$ 5,520 | \$ 5,783 | \$ 2,207 | \$ 1,733 | \$ 7,727 | \$ 7,516 |
| Cost of goods sold, exclusive of depreciation and amortization | (3,871) | (4,080) | (1,723) | (1,456) | (5,594) | (5,536) |
| Selling, general and administrative | (1,088) | (842) | (418) | (433) | (1,506) | (1,275) |
| Interest expense | (10) | (11) | - | - | (10) | (11) |
| Depreciation and amortization | (109) | (104) | (43) | (37) | (152) | (141) |
| Other income, net | 1 | - | 43 | 2 | 44 | 2 |
| Income (loss) from continuing operations before income tax provision | 443 | 746 | 66 | (191) | 509 | 555 |
| Income tax provision (benefit) | 134 | 335 | 17 | (86) | 151 | 249 |
| Income (loss) from continuing operations | 309 | 411 | 49 | (105) | 358 | 306 |
| Discontinued operations: | | | | | | |
| Loss from operations of a discontinued component, net of income tax benefit | - | - | - | (188) | - | (188) |
| Loss on disposal of QCC and AMP, net of income tax benefit | - | - | - | (262) | - | (262) |
| Loss from discontinued operations | - | - | - | (450) | - | (450) |
| Net income (loss) | \$ 309 | \$ 411 | \$ 49 | \$ (555) | \$ 358 | \$ (144) |
| Capital expenditures | \$ 107 | \$ 234 | \$ 28 | \$ 24 | \$ 135 | \$ 258 |

13. Other Income

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

14.

Subsequent Events

On October 16, 2013, the Company's wholly-owned subsidiary, The Ontario Knife Company, was awarded certain incentives from the County of Cattaraugus Industrial Development Agency (CCIDA) in connection with a proposed expansion of The Ontario Knife Company's facility in Franklinville, New York and other proposed capital expenditures. The incentives include certain real property tax and sales tax abatements in connection with the proposed project. The Ontario Knife Company entered into customary lease and leaseback arrangements with the CCIDA to facilitate the various tax incentives.

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

During the three months ended September 30, 2013 and 2012 approximately 25% and 26%, respectively, and 22% and 31% for the nine months ended September 30, 2013 and 2012, respectively, of the Company's revenues from continuing operations were derived from contracts with agencies of the U.S. Government or their prime contractors and their subcontractors. Sales of products sold for government applications decreased for the nine month period ended September 30, 2013 due to decreased government shipments at the Consumer Products Group and the Advanced Technology Group of approximately \$1,496,000 and \$603,000, respectively. Sales for both the Advanced Technology and Consumer Products military applications are dependent on governmental funding, which can change from year to year. There are risks that overall spending may be reduced in the future, specific programs may be eliminated or that the Company may fail to win new business through the competitive bid process. While the Company is optimistic in relation to these potential opportunities, it recognizes that sales to the government are affected by defense budgets, the foreign policies of the U.S. and other nations, the level of military operations and other factors, and as such, it is difficult to predict the impact on future financial results.

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The Company's commercial business is affected by such factors as uncertainties in today's global economy, global competition, the vitality and ability of the commercial aviation industry to purchase new aircraft, the effects of terrorism and the threat of terrorism, market demand and acceptance both for the Company's products and its customers' products which incorporate Company made components.

The ATG continues its aggressive business development efforts in its primary markets and is broadening its activities to include new domestic and foreign markets that are consistent with its core competencies. Although the ATG backlog continues to be strong, actual scheduled shipments may be delayed/changed as a function of the Company's customers' final delivery determinations that may be based on changes in the global economy and other factors.

The Company's CPG develops new commercial products and products for government and military applications. Included in the significant uncertainties in the near and long term is the impact of expected budget cuts for military spending and vagaries inherent in the government procurement process and programs.

Increasing profitability is dependent on many things, primarily revenue growth and the Company's ability to control operating expenses. The Company continues to address these challenges by working to improve operating efficiencies and focusing on new product development and the acquisition and development of new product lines while continuing to respond to U.S. government procurement requests for quotes.

Results of Operations

The following table compares the Company's consolidated statements of operations data for the nine and three months ended September 30, 2013 and 2012 (\$000's omitted).

| | Nine Months Ended September 30, | | | | | | 2013 vs. 2012 | |
|---|---------------------------------|---------------|-----------|---------------|------------------|-----------------------------|---------------|--|
| | 2013 | | 2012 | | Dollar Change | % Increase (Decrease) | | |
| | Dollars | % of Sales | Dollars | % of Sales | | | | |
| Revenue: | | | | | | | | |
| Advanced Technology | \$ 16,709 | 72.2 % | \$ 16,671 | 71.5 % | \$ 38 | | 0.2 % | |
| Consumer Products | 6,427 | 27.8 % | 6,631 | 28.5 % | (204) | | (3.1 %) | |
| | 23,136 | 100.0 % | 23,302 | 100.0 % | (166) | | (0.7 %) | |
| Cost of goods sold, exclusive of depreciation and amortization | 17,164 | 74.2 % | 17,081 | 73.3 % | 83 | | 0.5 % | |
| Selling, general and administrative | 4,140 | 17.9 % | 3,753 | 16.1 % | 387 | | 10.3 % | |
| Depreciation and amortization | 460 | 2.0 % | 437 | 1.9 % | 23 | | 5.3 % | |
| Total costs and expenses | 21,764 | 94.1 % | 21,271 | 91.3 % | 493 | | 2.3 % | |
| Operating income, net | 1,372 | 5.9 % | 2,031 | 8.7 % | (659) | | (32.4 %) | |
| Interest expense | 31 | 0.1 % | 34 | 0.1 % | (3) | | (8.8 %) | |
| Other income, net | (45) | (0.2 %) | (12) | (0.1 %) | (33) | | 275.0 % | |
| Income tax provision | 347 | 1.5 % | 663 | 2.8 % | (316) | | (47.7 %) | |
| Income from continuing operations | 1,039 | 4.5 % | 1,346 | 5.9 % | (307) | | (22.8 %) | |
| Loss from operations of a discontinued component, net of income tax benefit | - | - | (591) | (2.5 %) | 591 | | 100.0 % | |
| Loss on disposal of QCC and AMP, net of income tax benefit | - | - | (530) | (2.3 %) | 530 | | 100.0 % | |
| | - | - | (1,121) | (4.8 %) | 1,121 | | 100.0 % | |

Loss from
discontinued
operations
Net income

| | | | | | | | | |
|----------|-----|---|--------|-----|---|--------|-------|---|
| \$ 1,039 | 4.5 | % | \$ 225 | 1.1 | % | \$ 814 | 361.8 | % |
|----------|-----|---|--------|-----|---|--------|-------|---|

| | Three Months Ended September 30, | | | | | | 2013 vs. 2012 | |
|---|----------------------------------|------------|-----------|------------|--------|------------|---------------|--|
| | 2013 | | 2012 | | Dollar | % Increase | | |
| | Dollars | % of Sales | Dollars | % of Sales | Change | (Decrease) | | |
| Revenue: | | | | | | | | |
| Advanced Technology | \$ 5,520 | 71.4 % | \$ 5,783 | 76.9 % | (263) | (4.5 %) | | |
| Consumer Products | 2,207 | 28.6 % | 1,733 | 23.1 % | 474 | 27.4 % | | |
| | 7,727 | 100.0 % | 7,516 | 100.0 % | 211 | 2.8 % | | |
| Cost of goods sold, exclusive of depreciation and amortization | 5,594 | 72.4 % | 5,536 | 73.7 % | 58 | 1.0 % | | |
| Selling, general and administrative | 1,506 | 19.5 % | 1,275 | 17.0 % | 231 | 18.1 % | | |
| Depreciation and amortization | 152 | 2.0 % | 141 | 1.9 % | 11 | 7.8 % | | |
| Total costs and expenses | 7,252 | 93.9 % | 6,952 | 92.6 % | 300 | 4.3 % | | |
| Operating income, net | 475 | 6.1 % | 564 | 7.4 % | (89) | (15.8 %) | | |
| Interest expense | 10 | 0.1 % | 11 | 0.1 % | (1) | (9.1 %) | | |
| Other income, net | (44) | (0.6 %) | (2) | 0.0 % | (42) | 2,100.0 % | | |
| Income tax provision | 151 | 2.0 % | 249 | 3.3 % | (98) | (39.4 %) | | |
| Income from continuing operations | 358 | 4.6 % | 306 | 4.0 % | 52 | 17.0 % | | |
| Loss from operations of a discontinued component, net of income tax benefit | - | - | (188) | (2.5 %) | 188 | 100.0 % | | |
| Loss on disposal of QCC and AMP, net of income tax benefit | - | - | (262) | (3.5 %) | 262 | 100.0 % | | |
| Loss from discontinued operations | - | - | (450) | (6.0 %) | 450 | 100.0 % | | |
| Net income (loss) | \$ 358 | 4.6 % | \$ (144) | (2.0 %) | \$ 502 | (348.6 %) | | |

Revenue

The Company's consolidated revenues from continuing operations increased approximately \$211,000 or 2.8% for the three month period ended September 30, 2013 when compared to the same three month period ended September 30, 2012. This increase is best explained by a general increase in commercial shipments at the CPG and ATG combined with variations from timing differences on government shipments at both the CPG and ATG within the quarter. The Company's consolidated revenues from continuing operations decreased \$166,000 or 0.7% for the nine month period ended September 30, 2013 when compared to the same nine month period in 2012. This variation in sales is the result of a decrease in shipments to the U.S Government and its prime vendors at both ATG and CPG which were mostly offset by an increase in commercial sales at both the ATG and CPG. Shipments to the Government and its prime vendors decreased approximately \$1,496,000 at the CPG while ATG shipments to the Government and its prime vendors decreased by approximately \$603,000 due to budget cuts for military spending and vagaries inherent in the government procurement process and programs.

Cost of Goods Sold

Cost of goods sold as a percentage of revenues decreased for the three month periods ended and increased for the nine month period ended September 30, 2013 and 2012. Such fluctuations are primarily due the mix of products sold at both ATG and CPG. Also contributing to the increase in cost of sales is additional engineering and engineering support associated with development and design changes to new and existing products. These costs are expensed as incurred.

The Company continues to aggressively pursue cost saving opportunities in material procurements and other operating efficiencies including capital investments in updated and new equipment/machinery as well as investing in the development and training of its labor force.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses increased approximately \$231,000 or 18.1% for the three month period ended September 30, 2013 and increased \$387,000 or 10.3% for the nine months periods ended September 30, 2013 when compared to the same periods in 2012. Selling, general and administrative expenses are attributable to marketing of products (i.e., costs of internal and external sales efforts, catalog production, and the promotion of new and existing products in current and new markets). Also included in SG&A expenses are labor and related costs for general and administrative support, accounting, professional, legal and information technology costs. Attributing to the increase in SG&A costs are an increase of approximately \$84,000 for the three month period ended September 30, 2013 and \$86,000 for the nine month period ended September 30 2013, in royalty and commissions associated with the increased commercial sales at the CPG along with an increase in stock based compensation, salaries, wages and employee benefits costs.

Interest Expense

Interest expense remained relatively consistent for the three and nine month periods ended September 30, 2013 compared to the same period in 2012 due to interest rates which have remained consistent. See also Note 6, Long-Term Debt, of the accompanying consolidated financial statements for information on long-term debt.

Depreciation and Amortization Expense

Depreciation and amortization expense increased approximately \$11,000 or 7.8% for the three month period ended September 30, 2013 and increased \$23,000 or 5.3% for the nine month period ended September 30, 2013 when compared to the same periods in 2012. Depreciation expense fluctuates due to variable estimated useful lives of depreciable property (as identified in Note 2, Summary of Significant Accounting Policies, of the accompanying consolidated financial statements) as well as the amount and nature of capital expenditures in current and previous periods. It is anticipated that the Company's future capital expenditures will, at a minimum, follow the Company's requirements to support its manufacturing delivery commitments and to meet certain information technology related capital expenditure requirements.

Other Income

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

Income Taxes

The Company's continuing operations effective tax rate was approximately 29.4% and 44.9% for the three month periods ended September 30, 2013 and 2012, respectively, and approximately 25.2% and 33.0% for the nine months ended September 30, 2013 and 2012, respectively, and the discontinued operations effective tax rate was approximately 34.0% for the three and nine month periods ended September 30, 2012, respectively. The effective tax rate in both years reflects federal and state income taxes, permanent non-deductible expenditures and the expected tax benefit for manufacturing deductions allowable under the American Jobs Creation Act of 2004. The Company recorded a tax benefit of approximately \$40,000 in the first quarter of 2013 to reflect the research and development tax credit re-enactment related to fiscal 2012. See also Note 8, Income Taxes, of the accompanying consolidated financial statements for information concerning income tax.

Income From Continuing Operations

Income from continuing operations for the three month period ended September 30, 2013 increased \$52,000 or 17.0% when compared to the same period ended September 30, 2012. Income from continuing operations for the nine month period ended September 30, 2013 decreased \$307,000 or 22.8% when compared to the same period ended September 30, 2012. These period to period fluctuations in income from continuing operations are primarily the result of numerous challenges and opportunities at both the ATG and CPG as the business segments continue to invest in revenue growth efforts, facility and capability expansion to support numerous product development efforts. Such investments have a direct impact on operating results of the period incurred with expected benefits to be recognized in future periods..

Discontinued Operations

During the second quarter of 2012, the Company committed to a plan to enhance profit margins through the expected sale of a component. On September 18, 2012, Queen Cutlery Company (“QCC”), a wholly owned subsidiary of Servotronics Inc., completed the disposition of substantially all of its assets for cash consideration of \$650,000. QCC is accounted for as a discontinued operation in the accompanying consolidated financial statements. During the three and nine months ended September 30, 2013 there was no loss from discontinued operations related to QCC. A loss before income taxes of approximately \$116,000 and \$358,000 from discontinued operations was reported for the same three and nine month periods in 2012.

On July 23, 2012, Aero Metal Products, Inc. (“AMP”), a wholly owned subsidiary of Servotronics, Inc., gave notice of termination of a personal property capital lease for machinery and equipment previously reported under a \$588,000 capital lease with a related party. Due to the termination, beginning in July 2012, this lease is accounted for as an operating lease rather than a capital lease for the remaining term and the related assets and liabilities were removed from the consolidated balance sheet. In the third quarter of 2012, AMP ceased all manufacturing operations and in the fourth quarter of 2012, the Company surrendered all assets under the personal property and real property lease to the lessor, Aero Inc., a previously reported related party. During the three and nine months ended September 30, 2013 there was no loss from discontinued operations related to AMP. A loss before income taxes of approximately \$169,000 and \$537,000 from discontinued operations was reported for the same three and nine month periods in 2012.

Liquidity and Capital Resources

The Company’s primary liquidity and capital requirements relate to working capital needs; primarily inventory, accounts receivable and accounts payable as well as capital expenditures for property, plant and equipment and principal and interest payments on debt. At September 30, 2013, the Company had working capital of approximately \$19,813,000 (\$19,938,000 – December 31, 2012) of which approximately \$4,998,000 (\$5,573,000 – December 31, 2012) was comprised of cash and cash equivalents.

The Company generated approximately \$1,229,000 in cash from operations during the nine months ended September 30, 2013. Cash was generated primarily through net income, the application of prepaid income taxes, timing differences on payments to vendors and an increase in accrued employee compensation and benefit costs. The primary use of cash for the Company’s operating activities for the nine months ended September 30, 2013 include working capital requirements, mainly timing differences on collections of accounts receivable, increase in inventory, prepayments on insurances and property tax, other current assets and other accrued liabilities. Cash generated and used in operations is consistent with sales volume, customer expectations and competitive pressures. The Company’s

primary use of cash in its financing and investing activities in the first nine months of 2013 included approximately \$371,000 for the purchase of treasury shares and approximately \$406,000 for cash dividends paid on July 15, 2013. The Company also expended approximately \$1,124,000 for capital expenditures during the nine months ended September 30, 2013.

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At September 30, 2013, there are no material commitments for capital expenditures.

The Company also has an unsecured \$2,000,000 line of credit on which there is no balance outstanding at September 30, 2013. If needed, this can be used to fund cash flow required for operations or capital investment projects. The Company believes that it has adequate internal and external resources available to fund expected working capital and capital expenditure requirements through fiscal 2013 as supported by the level of cash/cash equivalents on hand, cash flow from operations and bank lines of credit.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company carried out an evaluation under the supervision and with the participation of its management, including the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of September 30, 2013. Based upon that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in SEC reports under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company's management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls

During the nine month period ended September 30, 2013, there were no changes in internal controls over financial reporting that have materially affected, or are reasonably likely to affect, the Company's internal controls over financial reporting.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

On July 17, 2013, the Company and its wholly-owned subsidiary, Aero Metal Products, Inc., received a summons and complaint filed by Aero, Inc. in the Supreme Court of the State of New York, County of Erie. Aero, Inc. is owned by the wife of a former officer and director of Servotronics. The complaint alleges various causes of action arising out of a Personal Property Lease and Real Property Lease between Aero Metal Products, Inc. and Aero, Inc. See Note 5, Property, Plant and Equipment, and Note 7, Capital Lease – Related Party, of the accompanying consolidated financial statements for additional information regarding the entry into and subsequent termination of these leases. The Company believes that the litigation is without merit and intends to defend against it vigorously. See also Note 10, Commitments and Contingencies, of the accompanying consolidated financial statements for further information regarding the litigation.

In August, 2013, Nicholas D. Trbovich, Jr., a former officer and director of Servotronics, commenced an arbitration proceeding against the Company in connection with the termination of his employment agreement effective September 29, 2012. The Company believes that the claims raised by Mr. Trbovich, Jr. are without merit and intends to defend against them vigorously. See Note 10, Commitments and Contingencies, of the accompanying consolidated financial statements for additional information regarding the termination of the employment agreement.

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

Item Risk Factors

1A.

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

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Company Purchases of Company's Equity Securities

| 2013 Periods | Total Number of Shares Purchased | Weighted Average Price Paid Per Share \$ | Total Number of Shares of Publicly Announced Plans or Programs | Maximum Number of Shares that may yet be Purchased under the Plans or Programs |
|---------------|----------------------------------|--|--|--|
| January-March | 16,952 | \$8.44 | 16,952 | 181,223 |
| April-June | 4,537 | \$7.72 | 4,537 | 176,686 |
| July | 3,511 | \$7.71 | 3,511 | 173,175 |
| August | 5,279 | \$8.51 | 5,279 | 167,896 |
| September | 14,027 | \$8.48 | 14,027 | 153,869 |
| Total | 44,306 | \$7.31 | 44,306 | 153,869 |

In January 2006, the Board of Directors authorized the purchase of up to 250,000 shares of the Company's outstanding common stock in the open market or in privately negotiated transactions. On October 31, 2008, the Company announced that its Board of Directors authorized the purchase of an additional 200,000 shares of the Company's common stock under the Company's current purchase program. As of September 30, 2013, the Company has purchased 296,131 shares and there remain 153,869 shares available to purchase under this program. There were 44,306 shares purchased by the Company during the nine month period ended September 30, 2013. Subsequent to quarter end there were 14,785 shares purchased by the Company through October 31, 2013 for approximately \$130,000.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item Exhibits

6.

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
- 101 The following materials from Servotronics, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) consolidated balance sheets, (ii) consolidated statements of income, (iii) consolidated statements of comprehensive income, (iv) consolidated statements of cash flows and (v) the notes to the consolidated financial statements.**

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

FORWARD-LOOKING STATEMENTS

In addition to historical information, certain sections of this Form 10-Q contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, such as those pertaining to the Company's capital resources and profitability. Forward-looking statements involve numerous risks and uncertainties. The Company derives a material portion of its revenues from contracts with agencies of the U.S. Government or their prime contractors. The Company's business is performed under fixed price contracts and the following factors, among others discussed herein, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements: uncertainties in today's global economy and global competition, and difficulty in predicting defense appropriations, the vitality of the commercial aviation industry and its ability to purchase new aircraft, the willingness and ability of the Company's customers to fund long-term purchase programs, and market demand and acceptance both for the Company's products and its customers' products which incorporate Company-made components. The success of the Company also depends upon the trends of the economy, including interest rates, income tax laws, governmental regulation, legislation, population changes and those risk factors discussed elsewhere in this Form 10-Q. Readers are cautioned not to place undue reliance on forward-looking statements, which reflect management's analysis only as of the date hereof. The Company assumes no obligation to update forward-looking statements.

SIGNATURES

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

Date: November 12, 2013

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