SERVOTRONICS INC /DE/
Form 10-K
March 24, 2014

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

Form 10-K

(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2013
or
o 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	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 Office) (Zip Code)
Registrant's telephone number, including area code (716) 655-5990

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

Title of each class	Name of each exchange on which registered
Common Stock, $.20 par value	NYSE MKT

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No x

Indicate by checkmark 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 x No o

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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. (Check one):

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

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

Based on the closing price of the Common Stock on June 28, 2013 ($7.80) (the last day of the registrant's most recently completed second fiscal quarter), the aggregate market value of the voting stock held by non-affiliates of the registrant was $12,112,057.

As of February 28, 2014 the number of $.20 par value common shares outstanding was 2,483,526.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the 2014 Annual Meeting of Shareholders are incorporated by reference in Part III.

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PART I

Item 1. 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 and other edged products.

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

The Company's shares currently trade on the New York Stock Exchange (NYSE) MKT under the symbol SVT.

Products

Advanced Technology Products

The Company 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, 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, as well as medical and industrial markets.

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

The Company may from time to time produce 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 Company 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 Company has also produced other products of its own and/or of a given design to meet customers' requirements.

Consumer Products

The Company designs, manufactures and sells a variety of edged products and tools. These products include a wide range of cutlery items such as steak, carving, bread, butcher and paring knives for household use and for use in restaurants, institutions and private industry, as well was fixed and folding knives for hunting, fishing and camping. The Company also sells knives and tools to the U.S. Government, related agencies, and allied foreign governments. These products include machetes, bayonets, axes, strap cutters, and other tools that are designed primarily for military and rescue/first-responder use, but are viable in commercial markets as well. The Company also produces and markets other edged products such as various specialty tools, putty knives, linoleum sheet cutters, field knives and SciMed items including scalpels and micro-spatulas. The Company manufactures its products from stainless or high carbon steel in numerous styles, designs, models and sizes. Substantially all of the Company’s commercial related products are intended for the medium to premium priced markets. See Discontinued Operations under Management’s Discussion and Analysis of Financial Condition for additional information.

Sales, Marketing and Distribution

Advanced Technology Products

The Company's Advanced Technology Group (ATG) products are marketed throughout the United States and in select foreign markets. Products are primarily 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 Company's professional staff.

During the Company's 2013 fiscal year, sales of advanced technology products pursuant to contracts with prime or subcontractors for various branches of the United States Government accounted for approximately 17% of the Company's consolidated revenues from continuing operations as compared to 20% in 2012. The Company's sales of advanced technology products to one customer, including various divisions and subsidiaries of a common parent company, amounted to approximately 29% in 2013 and 27% in 2012 of the Company's consolidated revenues from continuing operations. The Company also had sales to another ATG customer that amounted to approximately 11% and 10% of total consolidated revenues from continuing operations in 2013 and 2012. No other single customer represented more than 10% of the Company's consolidated revenues from continuing operations in either of these years.

The Company's prime contracts and subcontracts with the United States Government are subject to termination at the convenience of the Government. In the event of such termination, the Company is ordinarily entitled to receive payment for its costs and profits on work done prior to termination. Since the inception of the Company's business, less than 1% of its Government contracts have been terminated for convenience.

Consumer Products

The Company's consumer products are marketed throughout the United States and in select foreign markets. Consumer sales are moderately seasonal. Sales are to national and international distributors as well as directly to big box, hardware, supermarket, variety, department, discount, gift, drug, outdoors and sporting retailers. The Company's Consumer Products Group (CPG) also sells its knives and tools (principally machetes, bayonets, survival knives and kitchen knives) to various branches of the United States Government which accounted for approximately 4% of the Company's consolidated revenues from continuing operations in 2013 as compared to 9% in 2012. No single customer of the CPG represented more than 10% of the Company's consolidated revenues from continuing operations in 2013. The Company sells its products through its own sales resources and through independent manufacturers' representatives.

Business Segments

Business segment information is presented in Note 13, Business Segments, of the accompanying consolidated financial statements.

Intellectual Properties

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

Research Activities

The amount spent by the Company in research and development activities during its 2013 and 2012 fiscal years was not significant, but the Company does take advantage of tax credits for research and development activities when available. Such activities are expensed as incurred.

Environmental Compliance

The cost of compliance with current environmental laws has not been material and the Company does not anticipate that it will be in the future.

Manufacturing

The Company manufactures its advanced technology products in Elma, New York and its consumer products in Franklinville, New York.

Raw Materials and Other Supplies

The Company purchases raw materials and certain components for its products from outside vendors. The Company is generally not 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 Company to determine accurately its relative competitive position with respect to any of its products, the Company believes that it is a significant factor with respect to certain of its servo-control components. The Company’s share of the overall cutlery market is not significant.

The Company 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 Company encounters active competition with respect to its consumer products from numerous companies, many of which are larger in terms of manufacturing capacity, financial resources and marketing organization. Its principal competitors vary depending upon the customer and/or the products involved. The Company believes that it competes primarily with more than 20 companies with respect to its consumer products, in addition to foreign imports. To the Company’s knowledge, its principal competitors with regard to cutlery include World Kitchen, Inc., Benchmade Knife Company, Inc., Tramontina, Inc., Dexter-Russell Inc., W. R. Case & Sons Cutlery Company, Lifetime Hoan Corp. and Gerber.

The Company markets most of its products throughout the United States and to a lesser extent in select foreign markets. The Company believes that it competes in marketing its servo-control products primarily on the basis of operating performance, adherence to rigid specifications, quality, price and delivery and its consumer products primarily on the basis of price, quality and delivery.

Employees

The Company, at December 31, 2013, had 247 employees of which 231 are full time and are located in Western New York. Approximately 74% of its employees are engaged in production, inspection, packaging or shipping activities. The balance is engaged in executive, engineering, administrative, clerical or sales capacities.

Item 1A. Risk Factors

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

Item 1B. Unresolved Staff Comments

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

Item 2. Properties

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

Location	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	83,000
Franklinville,	12.7	Cutlery products	1-tile/wood	
New York			1-concrete/metal	
			1-concrete block	154,000

Pursuant to agreements with a local industrial development agency ("IDA") the Company leases and/or has options to purchase a facility and 38.4 acres of land in Elma, New York. The Company occupies the facility, which serves as the Company's headquarters and major manufacturing and research site for the Company's Advanced Technology Group. The transaction is accounted for by the Company as a capital lease. The facility secures the payment of an outstanding Industrial Development Bond (the "Bond") which financed construction of the facility.

The Bond was originally issued in the principal amount of $5,000,000 and, after a series of timely payments of principal and interest by the Company in accordance with the governing agreements, the outstanding Bond principal indebtedness has been reduced to approximately $2,600,000 as of December 31, 2013. When the Bond indebtedness has been fully paid, the Company has the right to purchase the facility for a nominal sum.

The property in Franklinville, New York is owned by the Company with no related encumbrances.

See the accompanying consolidated financial statements, including Note 10, Commitments and Contingencies, thereto, for further information with respect to the Company's lease commitments and a current expansion project at the Consumer Products Group in Franklinville, New York. The Company believes that the properties are suitable and adequate for the current production capacity. The properties leased or otherwise operated by the Company in the forgoing report are appropriately covered by insurance consistent with the advice of the Company's insurance consultant.

Item 3. Legal Proceedings

There are no legal proceedings which are material to the Company currently pending by or against the Company other than the information set forth in Note 10, Commitments and Contingencies, and Note 12, Litigation, in the Notes to the Consolidated Financial Statements. All other legal proceedings are ordinary routine litigation incidental to the business which are not expected to have a material adverse effect on the business or earnings of the Company.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) Price Range of Common Stock

The following table shows the range of high and low closing prices for the Company's common stock as reported by the NYSE MKT (symbol SVT) for 2013 and 2012.

	High	Low
2013		
Fourth Quarter	$ 8.90	$ 8.05
Third Quarter	9.08	7.41
Second Quarter	8.23	7.20
First Quarter	9.10	7.22
2012		
Fourth Quarter	$ 8.57	$ 6.52
Third Quarter	8.98	7.65
Second Quarter	10.29	7.50
First Quarter	11.00	8.96

(b) Approximate Number of Holders of Common Stock

Title of class	Approximate number of record holders (as of February 28, 2014)
Common Stock, $.20 par value per share	330

(c) Dividends on Common Stock

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 indicate that the Company will pay dividends on a regular or scheduled basis.

(d) Company Purchases of Company’s Equity Securities

2013 Periods	Total Number of Shares Purchased	Weighted Average Price $ Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that may yet be Purchased under the Plans or Programs
January-March	16,952	$8.48	16,952	181,223
April-June	4,537	$7.76	4,537	176,686
July-September	22,368	$8.57	22,368	154,318
October	15,623	$8.79	15,623	138,695
November	-	-	-	138,695
December	11,978	$8.26	11,978	126,717
Total	71,458	$8.49	71,458	126,717

In January 2006, the Board of Directors authorized the purchase of up to 250,000 shares of the Company’s outstanding common stock. The shares may be purchased in the open market or in privately negotiated transactions; and at times and in amounts that the Company deems appropriate. 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. In January 2014, the Company purchased 1,850 common shares at a weighted average price of $8.37 paid per share. As of February 28, 2014, the Company has purchased 325,133 shares and there remain 124,867 shares available to purchase under this program.

Item 6. Selected Financial Data

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

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Business Overview

The aviation and aerospace industries as well as markets for the Company’s consumer products continually face evolving challenges on a global basis. The operations of the Company can be affected by the trends of the economy, including interest rates, income tax laws, government regulation, legislation, and other factors. In addition, uncertainties in today’s global economy, competition from expanding manufacturing capabilities and technical sophistication of low-cost developing countries and emerging markets, currency policies in relation to the U.S. dollar of some major foreign exporting countries, the effect of terrorism, difficulty in predicting defense and other government appropriations under expected administrative budget cuts, 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.

Both the ATG and CPG markets are sensitive to domestic and foreign economic conditions and policies, which may create volatility in operating results from period to period. For example, the airline industry is sensitive to fuel price increases and economic conditions. These factors directly impact the demand for aircraft production as well as the amount of repair and overhaul required on in-service aircraft.

Government procurements are subject to Congressional appropriations and priorities that may change from year to year. Such changes could result in, but are not limited thereto, the expansion and/or contraction of Government procurement requirements, a reduction in funding, the continuation or termination of existing programs, the introduction of new programs requiring the funds that were originally directed to current programs, a stretch-out in Government delivery requirements or such other U.S. Government determinations that could result in increases or reductions of Government purchase orders for the ATG and/or the CPG products.

The Company's suppliers are also subject to all the pressures and volatility being generated by the current global economic conditions. Any interruption of the Company's continuous flow of material and product parts that are required for the manufacture of the Company's products could adversely impact the Company's ability to meet the Company's customers' delivery requirements. Consistent with the evolving requirements of the Aerospace Industry, companies are increasingly being requested to operate under Long-Term Agreements with their Customers on the basis of fixed prices, on the basis of targeted year to year price reductions and/or on the basis of year to year price adjustments predicated on mutually agreed indices and/or a combination of some or all of the above described pricing arrangements and/or otherwise. Therefore, productivity improvements and cost containment strategies are continuously sought within the Company's concept of continuous improvement. The Company's products are labor intensive and as such productivity improvements are expected to have positive effects on the Company's operating results. However, increased costs for raw material, purchased parts and/or labor will have the reverse effect. Therefore, there are strong incentives to continuously improve productivity and to contain/reduce costs.

If any adverse economic events reduce the number of Airliners and/or Aircraft being produced by the Company's relevant prime contractors, the negative effects of that reduction will in turn flow down through the supply chain. Also, certain major manufacturers have successfully imposed extended payment terms to their suppliers. At times, these extended terms of payment are not available to the Company when purchasing raw material such as aluminum, magnetic material, steel, etc. and/or other product support items and services. If the Company's customers delay their payments until after the extended due date or fail to pay, it could adversely impact the Company's operating results.

The Company's ability to manufacture products on a timely basis also depends on the Company's Suppliers' on-time delivery of raw material, sub components, machined parts and other necessary product support supplies. Interruptions of this flow of purchased materials could adversely affect the Company's operations.

Maximizing the Company's operations requires continued dedicated performances from the Company's key and other personnel. In the Company's markets and business arenas there is substantial competition for the services of the highest performing individuals. Competitors, customers and other companies who may have interest in the Company's most experienced and educated/highly trained personnel (i.e., Managerial, Engineering and Accounting/Administrative) are a continuing consequence of the Company's history of successful operational performance. Any unplanned replacement of such personnel may require the hiring of new personnel on an expedited basis (provided they are available) and may temporarily interrupt the Company's operations and efforts for continuous improvement.

In 2012, the Company made significant changes within the CPG as discussed in the "Results of Operations" section of this 10-K under the heading "Discontinued Operations." The Company expects these changes/product line eliminations to have a positive future impact on the Company's profitability but remains cautiously optimistic for the future within the constraints of today's global economic environment.

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. 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.

Management Discussion

During the years ended December 31, 2013 and 2012, approximately 21% and 29%, respectively, of the Company's revenues from continuing operations were derived from contracts with agencies of the U.S. Government or their prime contractors and their subcontractors. Sales of products sold for government applications decreased when comparing the results of 2013 to 2012, due to decreased government shipments at the ATG and CPG of approximately $717,000 and $1,612,000, respectively. The Company believes that government involvement in military operations overseas will continue to have an impact on the financial results in both the Advanced Technology and Consumer Products markets. While the Company is optimistic in relation to these potential opportunities, it recognizes that sales to the government are affected by defense budgets, the foreign policies of the U.S. and other nations, the level of military operations and other factors and, as such, it is difficult to predict the impact on future financial results.

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

The ATG continues its aggressive business development efforts in its primary markets and is broadening its activities to include new domestic and foreign markets that are consistent with its core competencies. 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 budgets cuts for military spending and vagaries inherent in the government procurement process and programs. The ATG and CPG continue to respond to U.S. government procurement requests for quotes. New product development activities are ongoing along with the acquisition and development of new product lines.

See also Note 13, Business Segments, of the accompanying consolidated financial statements for information concerning business segment operating results.

Results of Operations - Year 2013 as Compared to 2012

The following table compares the Company's consolidated statements of income data for the twelve months ended December 31, 2013 and 2012 ($000's omitted).

	Twelve Months Ended December 31,					
					2013 vs. 2012	
	2013 Dollars	% of Sales	2012 Dollars	% of Sales	Dollar Change	% Increase (Decrease)
Revenue:						
Advanced Technology	$22,204	73.3 %	$22,000	72.1 %	$204	0.9 %
Consumer Products	8,106	26.7 %	8,510	27.9 %	(404)	(4.7 %)
	30,310	100.0 %	30,510	100.0 %	(200)	(0.7 %)
Cost of goods sold, exclusive of depreciation and amortization	22,799	75.2 %	22,416	73.5 %	383	1.7 %
Selling, general and administrative	5,638	18.6 %	5,047	16.5 %	591	11.7 %
Depreciation and amortization	640	2.1 %	614	2.0 %	26	4.2 %
Total costs and expenses	29,077	95.9 %	28,077	92.0 %	1,000	3.6 %
Operating income, net	1,233	4.1 %	2,433	8.0 %	(1,200)	(49.3 %)
Interest expense	41	0.1 %	52	0.2 %	(11)	(21.2 %)
Other income, net	(42)	(0.1 %)	(14)	0.0 %	(28)	200.0 %
Income tax provision	259	0.9 %	748	2.5 %	(489)	(65.4 %)
Income from continuing operations	975	3.2 %	1,647	5.3 %	(672)	(40.8 %)
Loss from operations of a discontinued component, net of income tax benefit	-	-	(647)	(2.1 %)	647	100.0 %
Loss on disposal of QCC and AMP, net of income tax benefit	-	-	(680)	(2.2 %)	680	100.0 %
Loss from discontinued operations	-	-	(1,327)	(4.3 %)	1,327	100.0 %
Net income	$975	3.2 %	$320	1.0 %		