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SERVOTRONICS INC /DE/  
Form 10QSB  
November 14, 2006

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended September 30, 2006

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 1 - 07109

SERVOTRONICS, INC.  
-----

(Exact name of small business issuer as specified in its charter)

Delaware  
-----

16-0837866  
-----

(State or other jurisdiction of  
incorporation or organization)

(IRS Employer  
Identification No.)

1110 Maple Street, Elma, New York 14059-0300  
-----

(Address of principal executive offices)

716-655-5990  
-----

(Issuer's telephone number, including area code)

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

Yes X . No .  
--- ---

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

Yes ; No X  
--- ---

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

| Class<br>-----                | Outstanding at October 31, 2006<br>----- |
|-------------------------------|--|
| Common Stock, \$.20 par value | 2,362,968                                |

Transitional Small Business Disclosure Format (Check one):

Yes ; No X  
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Signatures

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

ASSETS

Current assets:

- Cash and cash equivalents
- Accounts receivable
- Inventories
- Deferred income taxes
- Prepaid income taxes
- Other assets

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Total current assets

Property, plant and equipment, net

Other non-current assets

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:

Current portion of long-term debt  
Accounts payable  
Accrued employee compensation and benefit costs  
Other accrued liabilities

Total current liabilities

Long-term debt

Deferred income taxes

Other non-current liabilities

Shareholders' equity:

Common stock, par value \$.20; authorized  
4,000,000 shares; issued 2,614,506 shares  
Capital in excess of par value  
Retained earnings  
Accumulated other comprehensive loss

Employee stock ownership trust commitment  
Treasury stock, at cost 250,988 shares

Total shareholders' equity

See notes to consolidated financial statements

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

| Three Months Ended |       | Nin   |
|--------------------|-------|-------|
| September 30,      |       | S     |
| 2006               | 2005  | 2006  |
| -----              | ----- | ----- |

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|   |          |          |           |
|---|----------|----------|-----------|
| Revenues                                      | \$ 5,646 | \$ 5,741 | \$ 17,811 |
| Costs and expenses:                           |          |          |           |
| Cost of goods sold, exclusive of depreciation | 4,353    | 4,083    | 13,685    |
| Selling, general and administrative           | 774      | 1,113    | 2,665     |
| Interest                                      | 65       | 67       | 191       |
| Depreciation and amortization                 | 134      | 164      | 480       |
| Other income, net                             | (40)     | (85)     | (413)     |
|   | -----    | -----    | -----     |
|   | 5,286    | 5,342    | 16,608    |
|   | -----    | -----    | -----     |
| Income before income tax provision            | 360      | 399      | 1,203     |
| Income tax provision                          | 133      | 147      | 445       |
|   | -----    | -----    | -----     |
| Net income                                    | \$ 227   | \$ 252   | \$ 758    |
|   | =====    | =====    | =====     |
| Income per share:                             |          |          |           |
| Basic   |          |          |           |
| -----   |          |          |           |
| Net income per share                          | \$ 0.12  | \$ 0.12  | \$ 0.38   |
|   | =====    | =====    | =====     |
| Diluted                                       |          |          |           |
| -----   |          |          |           |
| Net income per share                          | \$ 0.11  | \$ 0.12  | \$ 0.35   |
|   | =====    | =====    | =====     |

See notes to consolidated financial statements

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

CASH FLOWS RELATED TO OPERATING ACTIVITIES:

|   |        |
|---|--------|
| Net income  | \$ 758 |
| Adjustments to reconcile net income to net cash (used) provided by operating activities - |        |
| Depreciation and amortization   | 480    |
| Receipt of treasury shares  | (160)  |
| Change in assets and liabilities -  |        |
| Accounts receivable   | (400)  |
| Inventories   | (586)  |
| Prepaid income taxes  | (12)   |

Nine Mon  
September  
2006  
-----

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|  |          |
|--|----------|
| Other assets   | 295      |
| Other non-current assets                             | 144      |
| Accounts payable                                     | (55)     |
| Accrued employee compensation and benefit costs      | (269)    |
| Accrued income taxes                                 | (329)    |
| Other accrued liabilities                            | 90       |
|  | -----    |
| Net cash (used) provided by operating activities     | (44)     |
|  | -----    |
| CASH FLOWS RELATED TO INVESTING ACTIVITIES:          |          |
| Capital expenditures - property, plant and equipment | (226)    |
|  | -----    |
| Net cash used in investing activities                | (226)    |
|  | -----    |
| CASH FLOWS RELATED TO FINANCING ACTIVITIES:          |          |
| Principal payments on long-term debt                 | (160)    |
| Purchase of treasury shares                          | (917)    |
|  | -----    |
| Net cash used in financing activities                | (1,077)  |
|  | -----    |
| Net (decrease) increase in cash and cash equivalents | (1,347)  |
| Cash and cash equivalents at beginning of period     | 4,637    |
|  | -----    |
| Cash and cash equivalents at end of period           | \$ 3,290 |
|  | =====    |

See notes to consolidated financial statements

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (\$000's omitted in tables except for per share data)

1. Basis of presentation  
-----

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Item 310 of Regulation S-B. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

The accompanying consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. All such adjustments are of a normal recurring nature. Operating results for the three and nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. The consolidated financial statements should be read in conjunction with the annual report and the notes thereto.

2. Summary of significant accounting policies

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

Cash and cash equivalents  
-----

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

Revenue recognition  
-----

Revenues are recognized as services are rendered or as units are shipped and at the designated FOB point consistent with the transfer of title, risks and rewards of ownership. Such purchase orders generally include specific terms relative to quantity, item description, specifications, price, customer responsibility for in-process costs, delivery schedule, shipping point, payment and other standard terms and conditions of purchase and may provide for progress payments based on in-process costs as they are incurred.

Inventories  
-----

Inventories are stated at the lower of standard cost or net realizable value. Cost includes all cost incurred to bring each product to its present location and condition, which approximates actual cost (first-in, first-out). Market provisions in respect of net realizable value and obsolescence are applied to the gross value of the inventory. Pre-production and start-up costs are expensed as incurred.

Shipping and handling costs  
-----

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

Property, plant and equipment  
-----

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

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

|                            |            |
|----------------------------|------------|
| Buildings and improvements | 5-39 years |
| Machinery and equipment    | 5-15 years |
| Tooling                    | 3-5 years  |

Income taxes  
-----

The Company accounts for income taxes in accordance with SFAS No. 109,

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"Accounting for Income Taxes". SFAS No. 109 requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of operating loss and credit carryforwards and temporary differences between the carrying amounts and the tax bases of assets and liabilities. The Company and its subsidiaries file a consolidated federal income tax return and separate state income tax returns.

### Employee stock ownership plan

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

### Impairment of long-lived assets

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The Company reviews long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable based on undiscounted future operating cash flow analyses. If an impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal.

### Use of estimates

-----

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### New accounting pronouncements

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During the year ended December 31, 2005, the Financial Accounting Standards Board (FASB) issued a revision to SFAS 123 entitled SFAS 123 R - "Share-Based Payment", requiring companies to include the fair value of stock options granted as an expense in the statement of operations. This revision became effective and was adopted by the Company on January 1, 2006. See note 6, Common shareholders' equity.

During the year ended December 31, 2004, the FASB issued SFAS 151, "Inventory Costs". This Statement amends the guidance in Accounting Research Bulletin (ARB) No. 43, Chapter 4, "Inventory Pricing", to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "abnormal". In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. Statement 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005, with earlier application permitted in certain circumstances. The Company adopted SFAS 151 on January 1, 2006 and the adoption of this new standard did not have a significant impact on the Company's consolidated financial statements.

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### Risk Factors

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The aviation and aerospace industries as well as markets for the Company's consumer products are facing new and evolving challenges on a global

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basis. The success of the Company depends upon the trends of the economy, including interest rates, income tax laws, governmental regulation, legislation, and other risk factors. In addition, uncertainties in today's global economy, competition from expanding manufacturing capabilities and technical sophistication of low-cost developing countries, particularly in South and East Asia, currency policies in relation to the U.S. dollar of some major foreign exporting countries so as to maintain or increase a pricing advantage of their exports vis-a-vis U.S. manufactured goods, the effect of terrorism, difficulty in predicting defense and other government appropriations, the vitality of the commercial aviation industry and its ability to purchase new aircraft, the willingness and ability of the Company's customers to fund long-term purchase programs, volatile market demand and the continued market acceptance of the Company's advanced technology and cutlery products make it difficult to predict the impact on future financial results.

Fair Value of Financial Instruments  
-----

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

Reclassification of prior year balances  
-----

Certain prior period balances have been reclassified to conform with the current period presentation.

3. Inventories  
-----

Raw materials and common parts  
Work-in-process  
Finished goods

Less common parts expected to be used after one year  
(classified as long-term)

4. Property, plant and equipment  
-----

Land  
Buildings  
Machinery, equipment and tooling

Less accumulated depreciation and amortization

Property, plant and equipment includes land and building under a

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Sep  
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\$5,000,000 capital lease which can be purchased for a nominal amount at the end of the lease term. As of September 30, 2006, accumulated amortization on the building amounted to approximately \$1,700,000. The associated current and long-term liabilities are discussed in footnote 5 to the consolidated financial statements. The Company believes that it maintains property and casualty insurance in amounts adequate for the risk and nature of its assets and operations and which are generally customary in its industry.

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5. Long-term debt

-----

Industrial Development Revenue Bonds; secured by an equivalent letter of credit from a bank with interest payable monthly at a floating rate (3.94% at September 30, 2006) (A)

Term loan payable to a financial institution; interest at LIBOR plus 2% (6.00% at September 30, 2006); quarterly principal payments of \$17,500 commencing January 1, 2005; payable in full in the fourth quarter of 2009

Term loan payable to a financial institution; interest at LIBOR plus 2% (6.41% at September 30, 2006) quarterly principal payments of \$26,786 through the fourth quarter of 2011

Secured term loan payable to a government agency; monthly payments of approximately \$1,455 with interest waived payable through second quarter of 2012

Secured term loan payable to a government agency; monthly payments of \$1,950 including interest fixed at 3% payable through fourth quarter of 2015

Less current portion

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

The Company also has a \$1,000,000 line of credit on which there is no balance outstanding at September 30, 2006.

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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, 2006, the Company was in compliance with all of its debt covenants.

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6. Common shareholders' equity

|                                     | Common stock                  |        | Capital in             |                      |            | Treasury stock | Oth<br>compreh<br>los |
|-------------------------------------|-------------------------------|--------|------------------------|----------------------|------------|----------------|-----------------------|
|                                     | Number<br>of shares<br>issued | Amount | excess of<br>par value | Retained<br>earnings | ESOP       |                |                       |
| Balance December 31, 2005           | 2,614,506                     | \$523  | \$13,033               | \$3,609              | (\$ 2,034) | (\$ 520)       | (\$ 1,000)            |
| Net income                          | -                             | -      | -                      | 758                  | -          | -              | -                     |
| Purchase/receipt of treasury shares | -                             | -      | -                      | -                    | -          | (1,077)        | -                     |
| Other                               | -                             | -      | -                      | (3)                  | -          | -              | -                     |
| Balance September 30, 2006          | 2,614,506                     | \$523  | \$13,033               | \$4,364              | (\$ 2,034) | (\$ 1,597)     | (\$ 1,000)            |

In January of 2006, the Company's Board of Directors authorized the purchase by the Company of up to 250,000 shares of its common stock in the open market or in privately negotiated transactions. As of September 30, 2006, the Company has purchased 109,941 shares under this program. As of September 30, 2006, there remained 140,059 shares available to be purchased under the current buyback program. The Company has also received approximately 19,400 shares recorded at fair market value for the partial settlement of an obligation.

In December 2004, the Financial Accounting Standards Board issued SFAS 123R, Share-Based Payment ("SFAS 123R"). SFAS 123R supersedes SFAS 123, Accounting for Stock Based Compensation, and Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees ("APB 25") and its related implementation guidance. On January 1, 2006, the Company adopted the provisions of SFAS 123R using the modified prospective transition method. Under this method, the Company is required to record compensation expense for all stock based awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding as of the beginning of the adoption and prior periods that have not been restated. Under SFAS 123R, compensation expense related to stock based payments are recorded over the requisite service period based on the grant date fair value of the awards.

Prior to the adoption of SFAS 123R, the Company accounted for employee stock options using the intrinsic value method in accordance with APB 25. Accordingly, no compensation expense was recognized for stock options issued to employees as long as the exercise price is greater than or equal to the market value of the common stock at the date of grant. In accordance with SFAS 123, the Company disclosed the summary of pro forma effects to reported net income as if the Company had elected to recognize compensation costs based on the fair value of the awards at the grant date.

There were no options granted or exercised in the nine month periods

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ended September 30, 2006 or 2005. As of September 30, 2006, there was \$3,000 of total unrecognized compensation cost related to non-vested options granted under the plan. That cost is expected to be recognized over a weighted average period of three years. During the nine month periods ended September 30, 2006 and 2005, no shares vested. As of September 30, 2006, 511,900 options of 513,900 options outstanding were exercisable. Exercisable options had a weighted average price of \$4.40 and a weighted average remaining contractual life of 6.3 years. The aggregate pretax intrinsic value based on the Company's closing price of \$6.15 as of September 30, 2006 was approximately \$1,092,184.

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### Earnings per share

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

|   | Three Months Ended<br>September 30, |         | Nine M<br>Sept |
|---|-------------------------------------|---------|----------------|
|   | 2006                                | 2005    | 2006           |
|   | ----                                | ----    | ----           |
| Net income  | \$ 227                              | \$ 252  | \$ 758         |
|   | =====                               | =====   | =====          |
| Weighted average common shares<br>outstanding (basic)           | 1,969                               | 2,071   | 2,011          |
| Incremental shares from assumed<br>conversions of stock options | 121                                 | 66      | 131            |
|   | -----                               | -----   | -----          |
| Weighted average common<br>shares outstanding (diluted)         | 2,090                               | 2,137   | 2,142          |
|   | =====                               | =====   | =====          |
| <br>Basic<br>-----  |                                     |         |                |
| Net income per share  | \$ 0.12                             | \$ 0.12 | \$ 0.38        |
|   | =====                               | =====   | =====          |
| <br>Diluted<br>-----  |                                     |         |                |
| Net income per share  | \$ 0.11                             | \$ 0.12 | \$ 0.35        |
|   | =====                               | =====   | =====          |

### 7. 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 involve the design, manufacture, and marketing of

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servo-control components (i.e., 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 significant portion of finished products are for foreign end use.

|                                      | Advanced Technology<br>Group<br>-----<br>Nine Months Ended<br>September 30,<br>2006      2005<br>----- |           | Consumer Products<br>Group<br>-----<br>Nine Months Ended<br>September 30,<br>2006      2005<br>----- |          |    |
|--------------------------------------|--|-----------|--|----------|----|
| Revenues from unaffiliated customers | \$ 11,346  | \$ 10,013 | \$ 6,465   | \$ 7,385 | \$ |
| Profit (loss)                        | \$ 2,517   | \$ 1,769  | \$ (496)   | \$ 122   | \$ |
| Interest expense                     | \$ (170)   | \$ (142)  | \$ (21)  | \$ (21)  |    |
| Depreciation and amortization        | \$ (350)   | \$ (380)  | \$ (130)   | \$ (121) |    |
| Other income, net                    | \$ 312   | \$ 99     | \$ 101   | \$ 148   |    |
| General corporate expense            |  |           |  |          | -- |
| Income before income tax provision   |  |           |  |          | \$ |

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|                                      | Advanced Technology<br>Group<br>-----<br>Three Months Ended<br>September 30,<br>2006      2005<br>----- |          | Consumer Products<br>Group<br>-----<br>Three Months Ended<br>September 30,<br>2006      2005<br>----- |          |    |
|--------------------------------------|---|----------|---|----------|----|
| Revenues from unaffiliated customers | \$ 3,838  | \$ 3,709 | \$ 1,808  | \$ 2,032 | \$ |
| Profit (loss)                        | \$ 841  | \$ 857   | \$ (135)  | \$ (128) | \$ |
| Interest expense                     | \$ (58)   | \$ (60)  | \$ (7)  | \$ (7)   |    |

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|                               |         |          |         |         |
|-------------------------------|---------|----------|---------|---------|
| Depreciation and amortization | \$ (94) | \$ (125) | \$ (40) | \$ (39) |
|                               | =====   | =====    | =====   | =====   |
| Other income, net             | \$ 23   | \$ 38    | \$ 17   | \$ 47   |
|                               | =====   | =====    | =====   | =====   |

General corporate expense

Income before income tax provision

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

Management Discussion

During the nine month period ended September 30, 2006 and for the comparable period ended September 30, 2005, approximately 31% and 43% respectively, of the Company's revenues were derived from contracts with agencies of the U.S. Government or their prime contractors and their subcontractors. Sales of products sold for government applications have decreased as the result of the previously reported scheduled completion of a significant government order to the CPG. The Company believes that government involvement in military operations overseas will continue to have a direct impact on the financial results in both the Advanced Technology and Consumer Products markets. While the Company remains optimistic in relation to these opportunities, it recognizes that sales to the government are affected by defense budgets, the foreign policies of the U.S. and other nations, the level of military operations and other factors and, as such, it is difficult to predict the impact on future financial results. The Company's commercial business is affected by such factors as uncertainties in today's global economy, global competition, the vitality and ability of the commercial aviation industry to purchase new aircraft, market demand and acceptance both for the Company's products and its customers' products which incorporate Company-made components.

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Results of Operations

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

|  | Relationship to<br>net revenues<br>three months ended<br>September 30,<br>2006 |       | 2005 | Period to<br>period \$<br>increase<br>(decrease)<br>06-05 | Period to<br>period %<br>increase<br>(decrease)<br>06-05 | Relationship to<br>net revenues<br>nine months ended<br>September 30,<br>2006 |       | 2005 |
|--|--|-------|------|---|--|---|-------|------|
|  | ----   | ----  | ---- | -----   | -----  | ----  | ----  | ---- |
| Net revenues                                     |  |       |      |   |  |   |       |      |
| Advanced Technology Group                        | 68.0%  | 64.6% |      | \$ 129  | 3.5%   | 63.7%   | 57.6% |      |
| Consumer Products Group                          | 32.0   | 35.4  |      | (224)   | (11.0)   | 36.3  | 42.4  |      |
|  | -----  | ----- |      | -----   |  | -----   | ----- |      |
|  | 100.0  | 100.0 |      | (95)  | (1.7)  | 100.0   | 100.0 |      |
| Cost of goods sold, exclusive of<br>depreciation | 77.1   | 71.1  |      | 270   | 6.6  | 76.8  | 74.4  |      |

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|                                     |       |       |         |        |       |       |
|-------------------------------------|-------|-------|---------|--------|-------|-------|
| Gross profit                        | 22.9  | 28.9  | (365)   | (22.0) | 23.2  | 25.6  |
| Selling, general and administrative | 13.7  | 19.4  | (339)   | (30.5) | 15.0  | 17.9  |
| Interest                            | 1.2   | 1.2   | (2)     | (3.0)  | 1.1   | 0.9   |
| Depreciation and amortization       | 2.4   | 2.9   | (30)    | (18.3) | 2.7   | 2.9   |
| Other income, net                   | (0.7) | (1.5) | 45      | (52.9) | (2.3) | (1.4) |
|                                     | 16.6  | 22.0  | (326)   | (25.9) | 16.5  | 20.3  |
| Income before income tax provision  | 6.3   | 6.9   | (39)    | (9.8)  | 6.7   | 5.3   |
| Income tax provision                | 2.3   | 2.5   | (14)    | (9.5)  | 2.4   | 2.0   |
| Net income                          | 4.0%  | 4.4%  | \$ (25) | (9.9)% | 4.3%  | 3.3%  |

The Company's consolidated net revenues increased approximately 2.4% for the nine month period and decreased approximately 1.7% for the three month period ended September 30, 2006 when compared to the same nine and three month periods in 2005. Increases in shipments in combination with certain price increases at the Company's ATG more than offset the decreases in nine month revenue at the Company's CPG, but did not fully offset the decrease in quarterly revenues at the CPG. The decrease in revenues at the CPG resulted from the scheduled and previously reported essential completion of a significant government contract as well as a decrease in shipments in commercial custom knives. Continued demand for the Company's ATG products drive increases in revenues.

Gross margins for the nine and three month periods ended September 30, 2006 decreased as a percentage of sales when compared to the same periods in 2005. Gross margins are affected by many factors including the mix of products sold in the period within the ATG and CPG as well as the composition of ATG and CPG sales to the total consolidated sales and, consistent with GAAP, the expensing of preproduction and development costs as they are incurred.

Selling, general and administrative (SG&A) expenses include variable costs such as legal and professional. There were expanded sales/marketing activities and costs at both the ATG and the CPG. Also, consistent with GAAP, these costs are expensed as they are incurred and because of this may result in timing differences and fluctuations from period to period. Therefore, these costs are not necessarily matched to their respective benefits.

Interest expense remained relatively consistent in both the nine and three month periods ended September 30, 2006 when compared to the same periods in 2005. The Company continues to reduce its outstanding debt during a period of increasing market driven interest rates.

Other income/expense for the nine month period ended September 30, 2006 includes approximately \$220,000 of net recovery, before tax, from a previously reported defalcation.

The Company's effective tax rate continues to be approximately 37% of pretax profits.

Net income increased by \$177,000 to \$758,000 for the nine months ended September 30, 2006 when compared to the same period of 2005 primarily due to the increase in revenues at the Company's ATG and positive effects of price increases and containment of variable cost activities.

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### Liquidity and Capital Resources

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The Company's primary liquidity and capital requirements relate to working capital needs; primarily inventory, accounts receivable, capital expenditures for property, plant and equipment and principal and interest payments on debt.

At September 30, 2006 the Company has working capital of approximately \$13.2 million of which \$3.3 million was comprised of cash and cash equivalents. The Company had a use of cash for the nine month period ended September 30, 2006 of \$44,000 from operations which was primarily related to the funding and payment of employee benefit/pension obligations, payment of income taxes as well as increases in accounts receivable and inventory aggregating \$986,000 related to timing of shipments of product. Additional uses of cash related to investment in treasury shares and capital expenditures for equipment as well as principal payments on long-term debt.

As of September 30, 2006 there are no material commitments for capital expenditures.

The Company also has a \$1,000,000 line of credit on which there was no balance outstanding at September 30, 2006. The Company's projected debt maturities are consistent with prior years.

### Item 3. CONTROLS AND PROCEDURES

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#### (a) Disclosure Controls and Procedures

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The Company carried out an evaluation under the supervision and with the participation of its management, including the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of the Company's disclosure controls and procedures as of September 30, 2006. Based upon that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures are effective in timely alerting them to the material information relating to the Company (or the Company's consolidated subsidiaries) required to be included in the Company's periodic filings with the SEC, such that the information relating to the Company, required to be disclosed in SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company's management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

#### (b) Changes in Internal Controls

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During the nine month period ended September 30, 2006, there were no changes in internal controls over financial reporting that have materially affected, or is reasonably likely to affect, our internal control over financial reporting.

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## PART II OTHER INFORMATION

### Item 1. LEGAL PROCEEDINGS

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None.

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

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### Purchases of Equity Securities by the Company and Affiliated Purchases

| Period                              | Total Number of<br>Shares Purchased | Average Price \$<br>Paid Per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plans or<br>Programs |
|-------------------------------------|-------------------------------------|------------------------------------|--|
| July 1 - July 31,<br>2006           | 250                                 | 6.23                               | 250  |
| August 1 - August 31,<br>2006       | 400                                 | 6.55                               | 400  |
| September 1 - September 30,<br>2006 | 4,500                               | 6.20                               | 4,500  |
| Total                               | 5,150                               | 6.23                               | 5,150  |

#### Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

#### Item 5. OTHER INFORMATION

None.

#### Item 6. EXHIBITS

- 10(A)(2) Amendment to employment contract for Dr. Nicholas D. Trbovich, Chief Executive Officer dated August 4, 2006 (Incorporated by reference to August 9, 2006 Form 8-K)
- 10(A)(5) Amendment to employment contract for Nicholas D. Trbovich, Jr., Vice President dated August 4, 2006 (Incorporated by reference to August 9, 2006 Form 8-K)
- 10(A)(6) Amendment to employment contract for Nicholas D. Trbovich, Jr., Vice President dated August 4, 2006 (Incorporated by reference to August 9, 2006 Form 8-K)
- 31.1 Certification of Chief Financial Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Executive Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.



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2002.

- 32.1 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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FORWARD-LOOKING STATEMENTS

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

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SIGNATURES

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

Date: November 13, 2006

SERVOTRONICS, INC.

By: /s/ Dr. Nicholas D. Trbovich, Chief Executive Officer  
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Dr. Nicholas D. Trbovich  
Chief Executive Officer

By: /s/ Cari L. Jaroslowsky, Chief Financial Officer  
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Cari L. Jaroslowsky

Chief Financial Officer

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