

SERVOTRONICS INC /DE/
Form 10KSB
March 31, 2005

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549
FORM 10-KSB

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2004
 TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____.
Commission File No. 1-07109

SERVOTRONICS, INC.

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

Delaware
(State or other jurisdiction of
incorporation or organization)

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

1110 Maple Street, Elma, New York
(Address of principal executive
offices)

14059
(Zip Code)

Issuer's telephone number: 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 American Stock Exchange

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

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes . No .

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

Issuer's revenues for its most recent fiscal year: \$22,113,000

As of March 14, 2005 the aggregate market value of the voting common stock held by non-affiliates of the registrant was \$7,503,970.275 based on the average of sales prices reported by the American Stock Exchange on that day.

As of March 14, 2005 the number of \$.20 par value common shares outstanding was 2,492,901.

DOCUMENTS INCORPORATED BY REFERENCE

Document Part of Form 10-KSB
2004 Proxy Statement

Part III

Transitional Small Business Disclosure Format. Yes . No

PART I

Item 1. Description of Business

General

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

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

Products

Advanced Technology Products

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

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

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

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

Consumer Products

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

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

Sales, Marketing and Distribution

Advanced Technology Products

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

During the Registrant's last fiscal year, sales of advanced technology products pursuant to subcontracts with prime or subcontractors for various branches of the United States Government or pursuant to prime contracts directly with the government accounted for approximately 22% of the Registrant's total revenues as compared to 30% in 2003. In 2004, sales of advanced technology products to each of Honeywell and United Technologies (including their respective subsidiaries and/or divisions) exceeded 10% of Registrant's total revenues. In 2003, sales of advanced technology products to each of Honeywell, Raytheon and United Technologies (including their respective subsidiaries and/or divisions) exceeded 10% of Registrant's total revenues. No other single customer represented more than 10% of the Company's revenues in 2004 or 2003.

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

Consumer Products

The Registrant's consumer products are marketed throughout the United States. Consumer sales are moderately seasonal. Sales are to hardware, supermarket, variety, department, discount, gift and drug stores. The Registrant's Consumer Products Group also sells its cutlery products (principally machetes, bayonets, survival knives and kitchen knives) to various branches of the United States Government which accounted for approximately 23% of the Registrant's total sales in 2004 and approximately 12% of total sales in 2003. No other single customer represented more than 10% of the Company's revenues in 2004. The Registrant sells its products through its own sales personnel and through independent manufacturers' representatives.

Business Segments

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

Intellectual Properties

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

Research Activities

The amount spent by the Registrant in research and development activities during its 2004 and 2003 fiscal years was not significant.

Environmental Compliance

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

Manufacturing

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

Raw Materials and Other Supplies

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

Competition

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

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

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

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

Employees

The Registrant, at December 31, 2004, had approximately 226 employees of which approximately 212 are full time. In excess of 81% of its employees are engaged in production, inspection, packaging or shipping activities. The balance are engaged in executive, engineering, administrative, clerical or sales capacities.

Item 2. Description of Properties

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

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

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

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

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

Item 3. Legal Proceedings

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

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

Not applicable.

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PART IIItem 5. Market for Common Equity, Related Stockholder Matters and Small Business Issuer Purchases of Equity Securities(a) Price range of common stock

The following table shows the range of high and low prices for the Registrant's common stock as reported by the American Stock Exchange for 2004 and 2003.

	<u>High</u>	<u>Low</u>	
2004			
Fourth Quarter	\$ 4.99	\$ 3.70	
Third Quarter	5.90	3.50	
Second Quarter	4.98	2.72	
First Quarter	3.54	2.75	
2003			
Fourth Quarter	\$ 3.55	\$ 2.00	
Third Quarter	2.45	2.10	
Second Quarter	2.28	1.85	
First Quarter	3.75	2.25	

(b) Approximate number of holders of common stock

<u>Title</u> <u>of</u> <u>class</u>	<u>Approximate number of</u> <u>record holders (as of</u> <u>December 31, 2004)</u>
Common Stock, \$.20 par value per share	567

(c) Dividends on common stock

No cash dividends were paid in 2004 or 2003.

(d) Securities Authorized for Issuance Under Equity Compensation Plans

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	270,000	\$3.126	80,000
Equity compensation plans not approved by security holders	194,200	\$6.057	76,600
Total	464,200	\$4.352	156,600

(e) Company Re-purchases of Equity Securities

None.

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

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

	Relationship to net revenues year ended		Period to period increase (decrease) year ended
	December 31, 2004	2003	2004-2003
Net revenues:			
Advanced technology products	51.3%	58.5%	10.4%
Consumer products	48.7	41.5	47.7
	100.0	100.0	25.8
Cost of goods sold, exclusive of depreciation	73.9	74.4	25.1
Gross profit	26.1	25.6	28.0
Selling, general and administrative	17.1	18.6	15.8
Interest	0.7	0.9	0.6

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Depreciation and amortization	3.0	3.8	(2.1)
	20.8	23.3	14.3
Income before income taxes	5.3	2.3	186.5
Income tax provision	2.0	0.9	182.2
Net income	3.3%	1.4%	189.0%

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Management Discussion

During the year ended December 31, 2004 and for the comparable period ended December 31, 2003, approximately 45% and 42% respectively of the Company's revenues were derived from contracts with agencies of the U.S. Government or their prime contractors and their subcontractors. Continued government involvement in military operations overseas has had a direct impact on the financial results in both the Advanced Technology and Consumer Products markets. Sales of products sold for government applications have increased approximately \$2,700,000 over 2003. While the Company remains optimistic in relation to these opportunities, it recognizes that sales to the government are affected by defense budgets, U.S. and foreign policy and the level of military operations and as such, it is difficult to predict the impact on future financial results.

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

Results of Operations - Year 2004 as Compared to 2003

The Company's consolidated results of operations for the year ended December 31, 2004 showed an approximate \$4,539,000 or 25.8% increase in net revenues with an increase in income before taxes of approximately \$757,000. The increase in revenues is primarily attributed to increased government shipments.

Gross profit increased 28.0% for the twelve month period ended December 31, 2004. The variation in gross profit can be attributed to several factors including year-to-year variations in the previously discussed front-end costs associated with new products and changes in design on existing products. The timing of such costs directly contributes to the fluctuation in gross profit from period to period as these costs are expensed as they occur and, as such, are not matched to their future revenues and benefits. As previously reported, while 2004 revenues from Consumer Products Group's combination combat knife and bayonet increased, a substantial amount of front-end costs associated with these revenues were expensed in prior periods. The Company continues to incur such costs on an ongoing basis associated with products for both the Advanced Technology Group (ATG) and Consumer Products Group (CPG). Another factor contributing to the increase in gross profit for the reported period is product mix.

Selling, general and administrative (SG&A) costs increased approximately 15.8% when compared to the same period in 2003. The increase in SG&A costs is attributed to increased marketing of the expanded sales effort of the ATG and CPG, however, the most significant impact has been increased costs for professional services and corporate governance necessitated by the Sarbanes-Oxley Act. The Company estimates that it has incurred in excess of \$200,000 on related expenses in 2004 and expects to continue to incur significant expenses in the future.

Interest expense remained consistent for the year ended December 31, 2004 when compared to the same period in 2003. Despite the decrease in the average outstanding balances on institutional debt, average market driven interest rates increased when comparing the twelve month period ending December 31, 2004 to the same period of 2003. See also Note 4 to the consolidated financial statements for information on long-term debt.

Depreciation and amortization expense decreased approximately 2.1% for the year ended December 31, 2004 when compared to the same period in 2003 due to variable estimated useful lives of depreciable property as identified in Note 1 to the consolidated financial statements.

The Company's effective tax rate was 37% in 2004 and 2003. The effective tax rate in both years reflects state income taxes, permanent non-deductible expenditures and the tax benefit on certain foreign sales. See also Note 6 to the consolidated financial statements for information concerning income tax rates.

Results of Operations - Year 2003 as Compared to 2002

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

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

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

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

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

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

Liquidity and Capital Resources

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

During the year ended December 31, 2004, the Company expended \$622,000 on capital expenditures as compared to \$148,000 in 2003.

At December 31, 2004, the Company has commitments for approximately \$70,000 in capital expenditures.

The Company also has a \$1,000,000 line of credit on which there is no balance outstanding at December 31, 2004.

Principal maturities of long-term debt are as follows: 2005 - \$381,000; 2006 - \$384,000, 2007 - \$386,000; 2008 - \$387,000, 2009 and thereafter - \$4,243,000.

Off Balance Sheet Arrangements

None.

Critical Accounting Policies

The Company prepares its consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that the Company believes are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the periods presented. Actual results could differ significantly from those estimates under different assumptions and

conditions. The Company believes that the following discussion addresses our most critical accounting policies, which are those that are most important to the portrayal of our financial condition and results of operations and which require our most difficult and subjective judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Note 1 to the accompanying consolidated financial statements includes a summary of the significant accounting policies used in the preparation of the consolidated financial statements.

New Accounting Pronouncements

Management reviewed recent accounting pronouncements and has not determined the effect these pronouncements will have on Financial Statement results. See Note 1 to the accompanying consolidated financial statements for further discussion of new accounting pronouncements.

Revenue Recognition

The Company's revenues are principally recognized as units are shipped and as terms and conditions of purchase orders are met.

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.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates include, but are not limited to, reserves and allowances for inventories and trade receivables. Actual results could differ from those estimates.

Item 7. Financial Statements

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

Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 8A. Controls and Procedures

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

In addition, our management reviewed our internal controls and, to management's knowledge, during the quarter ended December 31, 2004 there has been no change that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 8B. Other Information

None.

PART III

Item 9. Directors and Executive Officers of the Registrant

Information regarding directors and executive officers of the Registrant is incorporated herein by reference to the information included in the Registrant's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Registrant's 2004 fiscal year or such information will be included by amendment.

Code of Ethics

The Company has adopted a Code of Ethics and Business Conduct that applies to all directors, officers and employees of the Company as required by the listing standards of the American Stock Exchange. The Code is available on the Company's website at www.servotronics.com and the Company intends to disclose on this website any amendment to the Code. Waivers under the Code, if any, will be disclosed under the rules of the SEC and the American Stock Exchange.

Item 10. Executive Compensation

Information regarding executive compensation is incorporated herein by reference to the information included in the Registrant's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Registrant's 2004 fiscal year or such information will be included by amendment.

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

Information regarding security ownership of certain beneficial owners and management is incorporated herein by reference to the information included in the Registrant's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Registrant's 2004 fiscal year or such information will be included by amendment.

Also incorporated by reference is the information in the table under the heading "Securities Authorized for Issuance Under Equity Compensation Plans" included in Item 5 of this Form 10KSB.

Item 12. Certain Relationships and Related Transactions

Information regarding certain relationships and related transactions is incorporated herein by reference to the information included in the Registrant's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Registrant's 2004 fiscal year or such information will be included by amendment.

Item 13. Exhibits(a) Exhibits

<u>Exhibit number</u>	<u>Presentation</u>	<u>Reference</u>
3(A)(1)	Certificate of Incorporation	Exhibit 3(A)(1) to 1996 Form 10-KSB*
3(A)(2)	Amendments to Certificate of Incorporation dated August 27, 1984	Exhibit 3(A)(2) to 1996 Form 10-KSB*
3(A)(3)	Certificate of designation regarding Series I preferred stock	Exhibit 4(A) to 1987 Form 10-K*
3(A)(4)	Amendments to Certificate of Incorporation dated June 30, 1998	Exhibit 3(A)(4) to 1998 Form 10-KSB*
3(B)	By-laws	Exhibit 3(B) to 1986 Form 10-K*
4.1(A)	First amended and restated term loan agreement with Fleet Bank of New York dated October 4, 1993	Exhibit 4(A) to 1993 Form 10-KSB*

- 4.1(B) Second amended Exhibit
and restated 4.1(B) to
1999
term loan Form
agreement with 10-KSB*
Fleet Bank of
New York
dated February
26, 1999
- 4.1(C) First amendment Exhibit
to second 4.1(C) to
1999
amended and Form
restated term 10-KSB*
loan agreement
with
Fleet Bank of
New York
dated December
17, 1999
- 4.1(D) Second Filed
amendment to a herewith
second
amended and
restated term
loan agreement
with
Fleet National
Bank
dated December
20, 2004

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

**Indicates management contract or compensatory plan or arrangement

<u>Exhibit number</u>	<u>Presentation</u>	<u>Reference</u>
4.2(A)	Letter of Credit Reimbursement Agreement with Fleet Bank dated December 1, 1994	Exhibit 4(B)(1) to 1994 10-KSB*
4.2(B)	First Amendment and Extension to Letter of Credit and Reimbursement Agreement with Fleet Bank of New York dated as of December 17, 1999	Exhibit 4.2(B) to 1999 Form 10-KSB*
4.2(C)	Second Amendment and Extension to Letter of Credit and Reimbursement Agreement originally dated December 1, 1994, with Fleet National Bank, dated as of December 20, 2004	Filed herewith
4.3	Agency Mortgage and Security Agreement dated as of December 1, 1994 from the Registrant and its subsidiaries	Exhibit 4(B)(2) to 1994 10-KSB*

- 4.4 Guaranty Exhibit
Agreement dated 4(B)(3) to
as
of December 1, 1994
1994 from 10-KSB*
the Registrant
and its
subsidiaries to
the Erie
County
Industrial
Development
Agency
(ECIDA),
Norwest Bank
Minnesota,
N.A., as Trustee,
and Fleet Bank
- 4.5 Shareholder Exhibit 4 to
Rights Plan Form
dated as of 8-K filed
August 27, August 27,
2002 2002*
- 10(A)(1) Employment Exhibit
contract for 10(A) to
1986
Dr. Nicholas D. Form
Trbovich, 10-K*
Chief Executive
Officer**

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

**Indicates management contract or compensatory plan or arrangement

<u>Exhibit number</u>	<u>Presentation</u>	<u>Reference</u>
10(A)(2)	Amendment to employment contract for Dr. Nicholas D. Trbovich, Chief Executive Officer**	Filed herewith
10(A)(3)	Amendment to employment contract for Dr. Nicholas D. Trbovich, Chief Executive Officer**	Filed herewith
10(A)(4)	Employment contract for Nicholas D. Trbovich, Jr. Vice President**	Filed herewith
10(B)	Form of Indemnification Agreement between the Registrant and each of its Directors and Officers**	Exhibit 10(E) to 1986 Form 10-K*
10(C)(1)	Loan agreement between the Company and its employee stock ownership trust, as amended	Exhibit 10(C)(1) to 1991 Form 10-K*
10(C)(2)	Stock purchase agreement	Exhibit 10(D)(2) to

between the 1988 Form
Company 10-K*
and its
employee
stock ownership
trust

10(D)(1)(a) 1989 Employees Exhibit A to
Stock Form 8:
Option Plan** Amendment
No. 1 to
1988 Form
10-K*

10(D)(1)(b) Amendment to Exhibit
1989 10(D)(1)(b)
to 1990
Employees Form
Stock Option 10-K*
Plan**

10(D)(1)(c) Amendment No. Exhibit
2 to 1989 10(D)(1)(d)
to 1991
Employees Form
Stock Option 10-K*
Plan**

10(D)(1)(d) 2000 Employees Exhibit
Stock 10(D)(1)(a)
to 2000
Option Plan** Form
10-KSB*

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

**Indicates management contract or compensatory plan or arrangement

<u>Exhibit number</u>	<u>Presentation</u>	<u>Reference</u>
10(D)(2)	Stock Option Agreement for Donald W. Hedges dated March 24, 1998**	Exhibit 10(D)(2) to 1998 Form 10-KSB*
10(D)(2)(a)	Stock Option Agreement for Donald W. Hedges dated July 7, 2000**	Exhibit 10(D)(2)(a) to 2000 Form 10-KSB*
10(D)(3)(b)	Stock Option Agreement for Nicholas D. Trbovich dated March 24, 1998**	Exhibit 10(D)(3)(b) to 1998 Form 10-KSB*
10(D)(3)(c)	Stock Option Agreement for Nicholas D. Trbovich dated July 7, 2000**	Exhibit 10(D)(3)(c) to 2000 Form 10-KSB*
10(D)(4)	Stock Option Agreement for William H. Duerig dated March 24, 1998**	Exhibit 10(D)(4) to 1998 Form 10-KSB*
10(D)(4)(a)	Stock Option Agreement	Exhibit 10(D)(4)(a) to 2000

for William H. Form
Duerig 10-KSB*
dated July 7,
2000**

10(D)(9) Land Lease Exhibit
Agreement 10(D)(9) to
1992
between TSV, Form
Inc. 10-KSB*
(wholly-owned
subsidiary
of the
Registrant) and
the
ECIDA dated
as of May 1,
1992, and
Corporate
Guaranty of the
Registrant
dated as of May
1, 1992

10(D)(10) Amendment to Exhibit
Land Lease 10(D) (11)
to 1993
Agreement and Form
Interim 10-KSB*
Lease
Agreement dated
November 19,
1992

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

**Indicates management contract or compensatory plan or arrangement

<u>Exhibit number</u>	<u>Presentation</u>	<u>Reference</u>
10(D)(11)	Lease Agreement dated as of December 1, 1994 between the Erie County Industrial Development Agency (ECIDA) and TSV, Inc.	Exhibit 10(D)(11) to 1994 10-KSB*
10(D)(12)	Sublease Agreement dated as of December 1, 1994 between TSV, Inc. and the Registrant	Exhibit 10(D)(12) to 1994 10-KSB*
10(D)(13)	2001 Long-Term Stock Incentive Plan	Appendix A to 2001 Proxy**
21	Subsidiaries of the Registrant	Exhibit 21 to 2001 10-KSB*
23	Consent of Independent Accountants Consent on Form S-8 dated March 31, 2005	Filed herewith
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	Filed herewith

to
Section 302 of
the Sarbanes-
Oxley Act of
2002.

31.2 Certification of Filed
Chief Executive herewith
Officer
pursuant to
Rule 13a-14 or
15d-14 of the
Securities
Exchange act of
1934, as
adopted pursuant
to
Section 302 of
the Sarbanes-
Oxley Act of
2002.

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

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

**Indicates management contract or compensatory plan or arrangement

<u>Exhibit number</u>	<u>Presentation</u>	<u>Reference</u>
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.	Filed herewith

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

Item 14. Principal Accountant Fees and Services

Information regarding principal accountant fees and services is incorporated herein by reference to the information included in the Registrant's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Registrant's 2004 fiscal year or such information will be included by amendment.

FORWARD-LOOKING STATEMENTS

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

SERVOTRONICS, INC. AND SUBSIDIARIES

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

Report of Independent Registered Public Accounting Firm

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

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations and cash flows present fairly, in all material respects, the financial position of Servotronics, Inc. (the Company) and its subsidiaries at December 31, 2004, and the results of their operations and their cash flows for the years ended December 31, 2004 and 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion

PricewaterhouseCoopers LLP

Buffalo, New York
March 31, 2005

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

	December 31, 2004
Assets	
Current assets:	
Cash	\$ 2,106
Accounts receivable	3,334
Inventories	6,841
Deferred income taxes	471
Other assets	1,544
Total current assets	14,296
Property, plant and equipment, net	6,527
Other non-current assets	537
	\$ 21,360
Liabilities and Shareholders' Equity	
Current liabilities:	
Current portion of long-term debt	\$ 381
Accounts payable	795
Accrued employee compensation and benefit costs	805
Accrued income taxes	67
Other accrued liabilities	152
Total current liabilities	2,200
Long-term debt	5,400
Deferred income taxes	434
Other non-current liabilities	304
Shareholders' equity:	
Common stock, par value \$.20; authorized 4,000,000 shares; issued 2,614,506 shares	523
Capital in excess of par value	13,033
Retained earnings	2,246
Accumulated other comprehensive loss	(125)
	15,677
Employee stock ownership trust commitment	(2,135)
Treasury stock, at cost 121,605 shares	(520)
Total shareholders' equity	13,022
	\$ 21,360

See notes to consolidated financial statements

SERVOTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS

(\$000 s omitted except per share data)

	Year Ended December 31,	
	2004	2003
Net revenues	\$ 22,113	\$ 17,574
Costs and expenses:		
Cost of goods sold, exclusive of depreciation	16,344	13,067
Selling, general and administrative	3,790	3,272
Interest	161	160
Depreciation and amortization	655	669
	20,950	17,168
Income before income taxes	1,163	406
Income tax provision	429	152
Net income	\$ 734	\$ 254
Income Per Share:		
<u>Basic</u>		
Net income per share	\$ 0.36	\$ 0.13
<u>Diluted</u>		
Net income per share	\$ 0.35	\$ 0.13

See notes to consolidated financial statements

SERVOTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

(\$000 s omitted)

	Year Ended December 31,	
	2004	2003
Cash flows related to operating activities:		
Net income	\$ 734	\$ 254
Adjustments to reconcile net income to net cash provided by operating activities -		
Depreciation and amortization	655	669
Deferred income taxes	(16)	184
Change in assets and liabilities -		
Accounts receivable	(846)	145
Inventories	(31)	(47)
Prepaid income taxes	73	72
Other assets	42	(125)
Other non-current assets	13	24
Accounts payable	246	131
Accrued employee compensation and benefit costs	73	(57)
Other accrued liabilities	(23)	66
Other non-current liabilities	27	(64)
Accrued income tax	67	-
Employee stock ownership trust payment	101	101
Net cash provided by operating activities	1,115	1,353
Cash flows related to investing activities:		
Capital expenditures - property, plant & equipment	(622)	(148)
Net cash used in investing activities	(622)	(148)
Cash flows related to financing activities:		
Proceeds from demand loan	572	250
Proceeds from long-term debt issuance	750	-
Payments on demand loan	(572)	(250)
Principal payments on long-term debt	(643)	(378)
Net cash provided by (used) in financing activities	107	(378)
Net increase in cash	600	827
Cash at beginning of period	1,506	679
Cash at end of period	\$ 2,106	\$ 1,506
Supplemental disclosures:		
=====		
Income taxes (received) paid	\$ 306	(\$131)
Interest paid	\$ 153	\$ 154

See notes to consolidated financial statements

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SERVOTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies

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

Principles of consolidation

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

Cash and cash equivalents

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

Revenue recognition

The Company's revenues are principally recognized as units are shipped and as terms and conditions of purchase orders are met.

Inventories

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

Shipping and handling costs

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

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	5-15 years	
Tooling		3-5 years

Income taxes

The Company and its subsidiaries file a consolidated federal income tax return and separate state income tax returns.

The Company follows the asset and liability approach to account for income taxes. This approach requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of operating loss and credit carryforwards and temporary differences between the carrying amounts and the tax bases of assets and liabilities.

Employee stock ownership plan

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

Use of estimates

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

New accounting pronouncements

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity. SFAS 150 changes the accounting guidance for certain financial instruments that, under previous guidance, could be classified as equity or mezzanine equity by now requiring those instruments to be classified as liabilities (or assets in some circumstances) on the balance sheet. Further, SFAS 150 requires disclosure regarding the terms of those instruments and settlement alternatives. SFAS is generally effective for all financial instruments entered into or modified after May 31, 2003, and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS 150 did not have any material impact on the Company's financial position, results of operations or cash flows.

In December 2003, the FASB issued a revision to SFAS No. 132 (SFAS 132), Employers' Disclosure about Pensions and Other Postretirement Benefits. This Statement retains the disclosures previously required by SFAS 132 but adds additional disclosure requirements about the assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. It also calls for the required information to be provided separately for pension plans and for other postretirement benefit plans. The disclosures required by this Statement are included in Note 5 to the Financial Statements.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, (SFAS 151) which clarifies the types of costs that should be expensed rather than capitalized as inventory. This statement also clarifies the circumstances under which fixed overhead costs associated with operating facilities involved in inventory processing should be capitalized. The provisions of SFAS No. 151 are effective for fiscal years beginning after June 15, 2005 and the Company will adopt this standard in its third quarter of fiscal 2005. We do not expect implementation of this statement to have a material effect on our consolidated financial position or results of operations.

The FASB issued Statement of Financial Accounting Standard (SFAS) No. 123 (Revised 2004) (SFAS No. 123R), Share-Based Payment, in December 2004. SFAS No. 123R is a revision of FASB Statement 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. The Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. This statement is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005, which will require the expensing of any stock options issued in the future.

Risk Factors

The aviation and aerospace industries as well as markets for the Company's consumer products are facing new and different challenges on a global basis. The success of the Company depends upon the trends of the economy, including interest rates, income tax laws, governmental regulation, legislation, and other risk factors. In addition, uncertainties in today's global economy, global competition, the effect of terrorism, difficulty in predicting defense and other government appropriations, the vitality of the commercial aviation industry and its ability to purchase new aircraft, the willingness and ability of the Company's customers to fund long-term purchase programs, volatile market demand and the continued market acceptance of the Company's advanced technology and cutlery products make it difficult to predict the impact on future financial results.

2. Inventories December 31, 2004
(\$000's omitted)

Raw materials and common parts	\$ 3,181
Work-in-process	3,268
Finished goods	640
	7,089
Less: common parts expected to be used after one year	(248)
	\$ 6,841

3. <u>Property, plant and equipment</u>	<u>December 31, 2004</u>
(\$000 s omitted)	
Land	\$ 25
Buildings	6,484
Machinery, equipment and tooling	10,349
	16,858
Less accumulated depreciation and amortization	(10,331)
	\$ 6,527

Property, plant and equipment includes land and building under a \$5,000,000 capital lease which can be purchased for a nominal amount at the end of the lease term. As of December 31, 2004, accumulated amortization on the building amounted to approximately \$1,400,000. The associated current and long-term liabilities are discussed in footnote 4 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.

4. <u>Long-term debt</u>	<u>December 31, 2004</u>
(\$000 s omitted)	
Industrial Development Revenue Bonds; secured by a letter of credit from a bank with interest payable monthly at a floating rate (2.12% at December 31, 2004)	\$ 4,150
Term loan payable to a financial institution interest at LIBOR plus 2% (4.00% at December 31, 2004); quarterly principal payments of \$17,500 commencing January 1, 2005; payable in full in the fourth quarter of 2009	500
Term loan payable to a financial institution interest at a rate of 5.25% at December 31, 2004, changing to LIBOR plus 2% (4.56% at January 4, 2005); quarterly principal payments of \$26,786 through the fourth quarter of 2011	750
Secured term loan payable to a government agency,	

monthly payments of approximately
\$1,455 with
interest waived payable through second 163
quarter of 2012

Secured term loan payable to a government
agency
monthly payments of \$1,950 including
interest
fixed at 3% payable through fourth 218
quarter of 2015

5,781
Less current portion (381)
\$
5,400

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

Principal maturities of long-term debt are as follows: 2005 - \$381,000; 2006 - \$384,000, 2007 - \$386,000; 2008 - \$387,000, 2009 and thereafter - \$4,243,000.

The Company also has a \$1,000,000 line of credit on which there is no balance outstanding at December 31, 2004. The average interest rate on draw-downs for 2004 was 5%.

Certain lenders require the Company to comply with debt covenants as described in the specific loan documents, including the debt service ratio. At December 31, 2004, the Company was in compliance with all of its debt covenants.

5. Employee benefit plans

Employee stock ownership plan (ESOP)

Under the Company's ESOP adopted in 1985, participating employees are awarded shares of the Company's common stock based upon eligible compensation and minimum service requirements. Upon inception of the ESOP, the Company borrowed \$2,000,000 from a bank and lent the proceeds to the trust established under the ESOP to purchase shares of the Company's common stock. The Company's loan to the trust is at an interest rate approximating the prime rate and is repayable to the Company over a 40-year term ending in December 2024. During 1987 and 1988, the Company loaned an additional \$1,942,000 to the trust under terms similar to the Company's original loan. Each year the Company makes contributions to the trust which the plan's trustees use to repay the principal and interest due the Company under the trust loan agreement. Shares held by the trust are allocated in the aggregate to participating employees in proportion to the amount of the loan repayment made by the trust to the Company. Since inception of the ESOP, approximately 405,000 shares have been allocated, exclusive of shares distributed to ESOP participants. At December 31, 2004 and 2003, approximately 422,000 and 445,000 shares, respectively, purchased by the ESOP remain unallocated.

Related compensation expense associated with the Company's ESOP, which is equal to the principal reduction on the loans receivable from the trust, amounted to \$101,000 in 2004 and 2003. Included as a reduction to shareholders equity is the employee stock ownership trust commitment which represents the remaining indebtedness of the trust to the Company. Employees are entitled to vote allocated shares and the ESOP trustees are entitled to vote unallocated shares and those allocated shares not voted by the employees.

Defined benefit plan

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

Narrative description of development of long-term rate of return

The Company uses historical performance in the market blended with consideration for inflation, risk-free rate of return.

Narrative description of investment policy strategies

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

Weighted - Average Assumptions

	December 1,	
	2004	2003
Discount rate for benefit obligations	5.75%	6.0%
Discount rate for net periodic pension cost	6.0%	6.5%
Rate of compensation increase	N/A	N/A
Long-term rate of return and expected long-term return on plan assets	8.0%	8.0%

Accumulated benefit obligation

	December 1,	
	2004	2003
Accumulated benefit obligations (ABO)	\$437,926	\$429,351
Projected benefit obligations (PBO)	\$437,926	\$429,351
Plan assets	\$364,636	\$345,256

Excess of ABO over plan assets \$73,290 \$84,095

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Pension cost and employer contributions

	2004	December 1, 2003
Net periodic pension cost	\$ 29,036	\$ 25,101
Anticipated employer contributions	\$ 50,491	\$ 51,364

Estimated future benefit payments

	2004	2003
Plan year 2005	\$ 24,430	\$ 22,157
Plan year 2006	\$ 25,569	\$ 23,607
Plan year 2007	\$ 27,164	\$ 24,791
Plan year 2008	\$ 27,824	\$ 26,077
Plan year 2009	\$ 28,702	\$ 26,837
	147,998	141,434
Plan years 2010 through 2014	\$	\$

6. Income tax provision

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

	2004	2003
	(\$000 s omitted)	
Current:		
Federal income tax (benefit)	\$ 388	(\$37)
State income tax	57	5
	445	(32)
Deferred:		
Federal income tax (benefit)	(13)	(177)
State income tax	(3)	7
	(16)	184
	\$ 429	\$ 152

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

	2004	2003
Statutory rate	34%	34%
Increase resulting from:		
State income taxes (less federal effect)	3%	2%
Extraterritorial income exclusion	(2%)	(3%)
Nondeductible expenses	1%	3%

Other

1%
37%

1%
37%

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At December 31, 2004, the deferred tax assets (liabilities) were comprised of the following:

	(\$000 s omitted)
Inventories	\$ 247
Accrued employee compensation and benefit costs	222
Operating loss and credit carryforwards	62
Minimum pension liability	64
Other	10
Total deferred tax assets	605
Property, plant and equipment	(558)
Other liabilities	(10)
Total deferred tax liabilities	(568)
Net deferred tax asset	\$ 37

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

At December 31, 2004, the Company also has New York State net operating loss carryforwards of approximately \$556,000 (approximately a \$18,000 net tax benefit) that begin to expire in 2019. The Company also has a State of Pennsylvania net operating loss carryforward of approximately \$1,312,000 (approximately a \$43,000 net tax benefit) that begins to expire in 2006.

On October 22, 2004, the President of the United States signed the American Jobs Creation Act of 2004 (the Act). The Act provides a deduction for income from qualified domestic production activities, which will be phased in from 2005 through 2010. In return, the Act also provides for a two-year phase-out of the existing extra-territorial income exclusion (ETI) for foreign sales that was viewed to be inconsistent with international trade protocols by the European Union. The Company has not determined the effect this Act will have on future effective tax rates.

7. Common shareholders equity

	Common stock Number of shares issued (\$000 s omitted except share amounts)	Amount	Capital in excess of par value	Retained Earnings	ESOP	Treasury stock	Comprehensive income	Accumulated other comprehensive income (loss)
Balance December 31, 2002	2,614,506	\$523	\$13,361	\$1,262	(\$2,337)	(\$1,054)		(\$82)
Comprehensive income:								
Net income	-	-	-	254	-	-	\$254	-
Other comprehensive loss, net of tax:								
Minimum pension liability adjustment	-	-	-	-	-	-	(25)	(25)
Other comprehensive loss	-	-	-	-	-	-	(25)	-
Comprehensive income	-	-	-	-	-	-	\$229	-
Compensation expense	-	-	-	-	101	-		-
Treasury shares issued for deferred compensation obligation	-	-	(328)	-	-	534		-
Balance December 31, 2003	2,614,506	\$523	\$13,033	\$1,516	(\$2,236)	(\$520)		(\$107)
Comprehensive income:								
Net income	-	-	-	734	-	-	\$734	-
Other comprehensive loss, net of tax:								
Minimum pension	-	-	-	-	-	-	(18)	(18)

liability								
adjustment								
Other								
comprehensive								
loss	-	-	-	-	-	-	(18)	-
Comprehensive	-	-	-	-	-	-	\$716	-
income								
Compensation	-	-	-	-	101	-	-	
expense								
Treasury shares								
issued for								
deferred								
compensation								
obligation	-	-	-	-	-	-		-
Other	-	-	-	(4)	-	-		-
Balance December								
31, 2004	2,614,506	\$523	\$13,033	\$2,246	(\$2,135)	(\$520)		(\$125)

Earnings per share

Basic earnings per share is computed by dividing net earnings by the weighted average number of shares outstanding during the period. Diluted earnings per share is computed by dividing net earnings by the weighted average number of shares outstanding during the period plus the number of shares of common stock that would be issued assuming all contingently issuable shares having a dilutive effect on earnings per share were outstanding for the period.

	Year Ended December 31,	
	2004	2003
	(\$000 s omitted except per share data)	
Net income	\$ 734	\$ 254
Weighted average common shares outstanding (basic)	2,052	2,001
Incremental shares from assumed conversions of stock options	46	10
Weighted average common shares outstanding (diluted)	2,098	2,011
<u>Basic</u>		
Net income per share	\$ 0.36	\$ 0.13
<u>Diluted</u>		
Net income per share	\$ 0.35	\$ 0.13

Other comprehensive loss

The minimum pension liability adjustment of \$125,000 (\$107,000 - 2003), which is net of taxes amounting to \$73,000 (\$63,000 - 2003), is the only component of other comprehensive loss for 2004.

Stock options

Under the Servotronics, Inc. 2000 Employee Stock Option Plan authorized by the Board of Directors and the 2001 Long-Term Stock Incentive Plan authorized by the Board of Directors and the Shareholders, and other separate agreements authorized by the Board of Directors, the Company has granted non-qualified options to certain Directors and Officers. The Company applies APB Opinion No. 25 and related interpretations in accounting for these Plans and the separate option agreements. Accordingly, no compensation expense has been charged to earnings in 2004 or prior years as stock options granted have an exercise price equal to the market price on the date of grant. At December 31, 2004, 156,600 shares of common stock were available under these plans. Options granted under these plans have durations of ten years and vesting periods ranging from six (6) months to four (4) years.

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

	Options Outstanding	Weighted Average Exercise Price (\$)
Outstanding as of December 31, 2002	319,200	5.37
Granted in 2003	145,000	2.045
Exercised in 2003	-	-
Forfeited in 2003	-	-
Outstanding as of December 31, 2003	464,200	4.01
Granted in 2004	-	-
Exercised in 2004	-	-
Forfeited in 2004	-	-
Outstanding as of December 31, 2004	464,200	4.01

The following tables summarize information about options outstanding at December 31, 2004:

Exercise Prices (\$)	Number Outstanding	Remaining	
		Contractual Life	Options Exercisable
8.50	93,000	3 years	93,000
3.8125	101,200	6 years	101,200
4.38	125,000	7 years	125,000
2.045	145,000	9 years	141,000
Total	464,200		460,200

The Company has adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation. If the compensation cost for these plans had been determined based on the Black-Scholes calculated values at the grant dates for awards consistent with the method prescribed by SFAS No. 123, the pro forma effects on the years ended December 31, 2004 and 2003 are as follows:

	<u>2004</u>	<u>2003</u>	
Net income:			
As reported	\$734,000	\$254,000	
Pro forma	\$703,781	\$128,000	
Earnings per common share:			
As reported - basic	\$0.36	\$0.13	
As reported - diluted	\$0.35	\$0.13	
Pro forma - basic	\$0.34	\$0.06	
Pro forma - diluted	\$0.34	\$0.06	

There were no options granted in 2004. There were 145,000 options granted in 2003. The Black-Scholes calculated estimated value of the options granted in 2003 was \$1.277. The assumptions used to calculate this value include a risk-free interest rate of 3.83%, an expected term of 10 years, and an annual standard deviation (volatility) factor of 46.6%. The Black-Scholes option pricing model was developed for use in estimating values of traded options that have no vesting restrictions and are fully transferable. In addition, option pricing models require the use of highly subjective assumptions, including the expected stock price volatility. Because the Company's stock options are restricted and have characteristics significantly different from those of traded options, and because changes in the subjective assumptions can materially affect the calculated estimated values, in the Company's opinion the existing models do not necessarily provide a reliable measure of the value of the Company's stock options. The estimated value calculated by the Black-Scholes methodology is hypothetical and does not represent an actual tangible Company expense or an actual tangible monetary transfer to the optionee. Further, for the reasons stated above (among others) and especially because of the volatility factor used in the Black-Scholes calculations for the Company's 2003 options, the derived estimated value may be, in the Company's opinion, substantially higher than the value which may be realized in an arms-length transaction under the above stated and existing conditions.

Shareholders' rights plan

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

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

8. Commitments

The Company leases certain equipment pursuant to operating lease arrangements. Total rental expense in 2004 and 2003 and future minimum payments under such leases are not significant.

9. Litigation

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

10. Business segments

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

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

Year ended <u>December 31, 2004</u>	Advanced Technology Group	Consumer Products Group	Consolidated (\$000's omitted)
Revenues from unaffiliated customers	\$ 11,354	\$ 10,759	\$ 22,113
Profit	\$ 1,844	\$ 871	2,715
Depreciation and amortization	\$ (506)	\$ (149)	(655)
Interest expense			(161)
General corporate expense			(736)
Income before income taxes			\$ 1,163
Identifiable assets	\$ 14,519	\$ 6,841	\$ 21,360
Capital expenditures	\$ 302	\$ 320	\$ 622
Year ended <u>December 31, 2003</u>	Advanced Technology Group	Consumer Products Group	Consolidated (\$000's omitted)
Revenues from unaffiliated customers	\$ 10,289	\$ 7,285	\$ 17,574
Profit	\$ 1,561	\$ 203	1,764
Depreciation and amortization	\$ (522)	\$ (147)	(669)
Interest expense			(160)
General corporate expense			(529)
Income before income taxes			\$ 406
Identifiable assets	\$ 13,920	\$ 6,021	\$ 19,941
Capital expenditures	\$ 53	\$ 95	\$ 148

The Company engages in a significant amount of business with the United States Government through sales to its prime contractors and otherwise. Such contracts by the Advanced Technology Group accounted for revenues of approximately \$4,800,000 in 2004 and \$5,200,000 in 2003. Similar contracts by the Consumer Products Group accounted for revenues of approximately \$5,100,000 in 2004 and \$2,100,000 in 2003. Sales of advanced technology products to one prime contractor, including various divisions and subsidiaries of a common parent company, amounted to approximately 14% in 2004 and 2003. The Company also had sales to another customer that amounted to approximately 17% of total revenues in 2004 and 2003. Another prime contractor provided sales of approximately 8% and 13% of total revenues in 2004 and 2003. No other single customer represented more than 10% of the Company's revenues in any of these years.

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