The Leading Edge of Control Technology

# SERVOTRONICS, INC.

Celebrating 60 Years
1959 - 2019

2018
Annual Report

As we begin 2019 and celebrate our Company's 60th anniversary, we are proud of our history and remain committed to seeking growth for our shareholders. Over the past several years, we have executed on our strategic plan and have achieved meaningful year-over-year revenue growth while also introducing new and expanded manufacturing capabilities that we believe will set the foundation for our continued growth and success.

2018 was another year of significant growth for Servotronics, Inc. The Company generated record breaking consolidated revenues of $47,857,000 (15.5% increase) for the year with a resulting net income of $3,498,000 or $1.49 per diluted share compared to $1,317,000 or $0.57 per diluted share in the previous year. This was the Company's fifth straight year of revenue growth and reflects our strategy to build long-term, sustainable and steady growth.

Our focus on implementing continuous improvements to our core operations and investing in our employees has led to strong growth at the Advanced Technology Group (ATG). The ATG secured its ninth straight year of record sales performance in 2018. ATG revenues grew to $40,415,000 for the year, a nearly 25% increase over 2017. ATG bookings grew to $48,500,000, surpassing the previous record of $38,155,000 set in 2017 by over 27 %. We expect bookings growth to continue in 2019 as our prior efforts to procure new programs for our products begins to translate into increased production rates. The ATG, in partnership with our customers, supports a wide range of platforms including the Boeing 787, Boeing 777X, Airbus 320, Airbus A320 NEO, Airbus A350, Airbus A380, F-35 Lightning II, Gulfstream 0650, CH-53K Helicopter, and KC-46A Tanker. These programs continue to build on Servotronics' legacy that includes the early Boeing 700 and Airbus 300 series aircraft, F-14, F-15, F-16, and FA-18 E/F jet fighters, the Ml Abrams tank family, Apache Longbow and Blackhawk helicopters, and other land, sea, and air applications.

The Company's Consumer Products Group (CPG) continued to face challenging market conditions in 2018 with revenues declining compared to the prior year. We remain committed to our recent efforts to diversify the CPG's revenue streams and improve operational efficiencies with the goal of improving bottom line performance. While we are pleased with our progress during 2018, we remain committed to the future and have positioned the Company to maximize opportunities for growth.

As we celebrate our 60th anniversary, I thank our dedicated employees who have made Servotronics successful in a variety of market conditions. Looking ahead to our future, we will continue to focus on responsiveness, reliability and innovation as we strive to deliver quality products and solutions that our customers expect. The accomplishments of 2018 show that our well-established corporate plan is proceeding successfully. It is our intention to continue this strong growth moving forward. We greatly appreciate the dedication, loyalty, and contributions of our Employees, Officers, Directors and Shareholders as we continue our efforts to expand our Company.

Kenneth D. Trbovich
Chairman of the Board,
Chief Executive Officer and President

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

# Form 10-K

(Mark One)
**[8] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2018**
**or**

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

**Commission File No. 1-07109**

## SERVOTRONICS, INC.

*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| **Delaware** | **16-0837866** |
| *(State or other jurisdiction of incorporation or organization)* | *(I. R. S. Employer Identification No.)* |

**1110 Maple Street**
**Elma, New York 14059**
*(Address of Principal Executive Office) (Zip Code)*

**Registrant's telephone number, including area code (716) 655-5990**

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

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes D No [8]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes D No [8]

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [8] No D

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).
Yes [8] No D

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [8]

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

Large accelerated filer D Accelerated filer D Non-accelerated filer [8] Smaller reporting company [8] Emerging growth company D

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Yes D No D

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)
Yes D No [8]

Based on the closing price of the Common Stock on June 30, 2018 $9.16 (the last day of the registrant's most recently completed second fiscal quarter), the aggregate market value of the voting stock held by non-affiliates of the registrant was $14,479,313.

As of March 1, 2019 the number of $.20 par value common shares outstanding was 2,573,044.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Proxy Statement for the 2019 Annual Meeting of Shareholders are incorporated by reference in Part III.

# PART I

## Item 1. Business

### General

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

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

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

### Products

#### Advanced Technology Products

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

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

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

The Company has also produced other products of its own and/or of a given design to meet customers’ requirements.

#### Consumer Products

The Company designs, manufactures and sells a variety of edged products, tools and specialty consumer products for domestic and international distribution. These products include a wide range of cutlery items such as steak, carving, bread, butcher and paring knives for household use and for use in restaurants, institutions and private industry, as well as equipment and gear including fixed and folding knives for hunting, fishing and camping. The Company also sells knives and tools to the U.S. Government, related agencies, and allied foreign governments. These products include machetes, bayonets, axes, strap cutters, and other tools that are designed primarily for military and rescue/first-responder use, but are viable in commercial markets as well. The Company also produces and markets other edged products such as various specialty tools, putty knives, linoleum sheet cutters, field knives and SciMed items including scalpels and micro-spatulas. The Company manufactures its products from stainless and high carbon steels, titanium, or synthetic materials in numerous styles, designs, models and sizes. Substantially all of the Company’s commercial related products are intended for the moderate to premium priced markets. The Company also provides plastic fabrication, metal fabrication and other engineering, design, and OEM/white-label manufacturing services to regional customers. This includes the production of a wide range of machined, engineered, and/or molded consumer and industrial products and components.

## Sales, Marketing and Distribution

### Advanced Technology Products

The Company's Advanced Technology Group (ATG) products are marketed throughout the United States and in select foreign markets. Products are primarily non-seasonal in nature. These products are sold to the United States Government, government prime contractors, government subcontractors, commercial manufacturers and end-users. Sales are made primarily by the Company's professional staff.

The Company's prime contracts and subcontracts with the United States Government, government subcontractors, and commercial manufacturers are subject to termination at the convenience of the customer. In the event of such termination, the Company is ordinarily entitled to receive payment for its costs and profits on work done prior to termination. Since the inception of the Company's business, less than 1% of its contracts have been terminated for convenience. The Company's sales of advanced technology products are composed primarily of a small group of customers with three customers accounting for 62% and 49% of the Company's total revenue in 2018 and 2017, respectively. See Note 1, Business Description and Summary of Significant Accounting Policies – Concentration of Credit Risks, of the accompanying consolidated financial statements for information related to sales concentrations.

### Consumer Products

The Company's consumer products are marketed throughout the United States and in select foreign markets. Consumer sales are moderately seasonal. Sales are direct to consumer, through national and international distributors, and through retailers such as big box, hardware, supermarket, variety, department, discount, gift, drug, outdoors and sporting stores. The Company's Consumer Products Group (CPG) also sells its knives and tools (principally machetes, bayonets, survival knives and kitchen knives) to various branches of the United States Government which accounted for less than 2% of the Company's consolidated revenues in 2018 and 2017. Additionally, the Company provides OEM and white label product design and manufacturing services to a regional customer base across a wide range of consumer and commercial industries. No single customer of the CPG represented more than 10% of the Company's consolidated revenues in 2018 or 2017. The Company sells its products and manufacturing services through its own sales resources, independent manufacturers' representatives and electronic commerce.

## Business Segments

Business segment information is presented in Note 11, Business Segments, of the accompanying consolidated financial statements.

## Intellectual Properties

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

**Research Activities**

The amount spent by the Company in research and development activities during its 2018 and 2017 fiscal years was not significant, but the Company does take advantage of tax credits for research and development activities when available. Such activities are expensed as incurred.

**Environmental Compliance**

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

**Manufacturing**

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

**Raw Materials and Other Supplies**

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

**Competition**

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

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

The Company encounters active competition with respect to its consumer products from numerous companies, many of which are larger in terms of manufacturing capacity, financial resources and marketing organization. Its principal competitors vary depending upon the customer and/or the products involved. The Company believes that it competes primarily with more than 20 companies with respect to its consumer products, in addition to foreign imports. To the Company's knowledge, its principal competitors with regard to cutlery include Corelle Brands Holdings, Inc., Benchmade Knife Company, Inc., Tramontina, Inc., Dexter-Russell Inc., W. R. Case & Sons Cutlery Company, Lifetime Brands, Inc., Cutco Corporation and Gerber. The Company also competes with other regional manufacturing companies for its molded plastic and metal and plastic fabrication services. To the Company's knowledge, its principal competitors with regard to manufacturing services include PM Plastics, Monarch Plastics and Ontario Plastics.

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

**Employees**

The Company, at December 31, 2018, had 340 employees of which 330 are full time at two locations in New York. Approximately 86% of its employees are engaged in production, inspection, packaging or shipping activities. The balance is engaged in executive, engineering, administrative, clerical or sales capacities. None are subject to a collective bargaining agreement.

**Item 1A.** **Risk Factors**

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

**Item 1B.** **Unresolved Staff Comments**

Not applicable.

**Item 2.** **Properties**

The Company owns real property as set forth in the following table with no related encumbrances:

| Location | Description | Principal product manufactured | Number of buildings and type of construction | Approx. floor area (sq. feet) |
|---|---|---|---|---|
| Elma, New York | Corporate Headquarters and Manufacturing Facility | Advanced technology products | 1-concrete block/steel | 83,000 |
| Franklinville, New York | Office and Manufacturing Facility | Cutlery products | 1-tile/wood 1-concrete/metal | 137,000 |

The Company believes that the properties are suitable and adequate for the current production capacity. The properties are appropriately covered by insurance consistent with the advice of the Company's insurance consultant.

**Item 3.** **Legal Proceedings**

See Note 8, Commitments and Contingencies, and Note 9, Litigation, for information regarding arbitration proceedings and other litigation matters. There are no other legal proceedings which are material to the Company currently pending by or against the Company other than ordinary routine litigation incidental to the business which is not expected to materially adversely affect the business or earnings of the Company.

**Item 4.** **Mine Safety Disclosures**

Not applicable.

## PART II

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

**(a) Market Information:**

The Company's common stock is listed on the NYSE American and trades under the symbol SVT.

**(b) Approximate Number of Holders of Common Stock**

| Title of class | Approximate number of record holders (as of March 1, 2019) |
|---|---|
| Common Stock, $.20 par value per share | 285 |

**(c) Dividends on Common Stock**

On May 18, 2018 the Company announced that its Board of Directors declared a $0.16 per share cash dividend. The dividend was subsequently paid on July 16, 2018 to shareholders of record on June 30, 2018 and was approximately $416,000 in the aggregate. These dividends do not represent that the Company will pay dividends on a regular or scheduled basis. The amount was recorded in dividends payable and as a reduction to retained earnings on the accompanying consolidated balance sheet. Approximately $376,000 of cash dividends were paid to shareholders in 2017.

**(d) Company Purchases of Company's Equity Securities**

| 2018 Periods | Total Number of Shares Purchased | Weighted Average Price $ Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Maximum Number of Shares that may yet be Purchased under the Plans or Programs (1) |
|---|---|---|---|---|
| January - March | 11,341(2) | $ 10.40 | - | 100,670 |
| April - June | 3,350 | 9.29 | 3,350 | 97,320 |
| July - September | - | - | - | 97,320 |
| October | - | - | - | 97,320 |
| November | - | - | - | 97,320 |
| December | 2,343 | 10.37 | 2,343 | 94,977 |
| Total | 17,034 | $ 10.18 | 5,693 | 94,977 |

(1) The Company's Board of Directors authorized the purchase of up to 450,000 shares of its common stock in the open market or in privately negotiated transactions. As of December 31, 2018, the Company has purchased 355,023 shares and there remain 94,977 shares available to purchase under this program. There were 5,693 shares purchased by the Company in 2018.

(2) Includes 11,341 shares withheld/purchased by the Company in January 2018 to satisfy statutory minimum withholding tax requirements for those participants who elected this option as permitted under the Company's 2012 Long-Term Incentive Plan.

**Item 6. Selected Financial Data**

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

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

**Business Overview**

The aviation and aerospace industries as well as markets for the Company's consumer products continually face evolving challenges on a global basis. The operations of the Company can be affected by the trends of the economy, including interest rates, income tax laws, government regulation, legislation, and other factors. In addition, uncertainties in today's global economy, competition from expanding manufacturing capabilities and technical sophistication of low-cost developing countries and emerging markets, currency policies in relation to the U.S. dollar of some major foreign exporting countries, the effect of terrorism, difficulty in predicting defense and other government appropriations, the vitality of the commercial aviation industry and its ability to purchase new aircraft, the willingness and ability of the Company's customers to fund long-term purchase programs, volatile market demand and the continued market acceptance of the Company's advanced technology and cutlery products make it difficult to predict the impact on future financial results.

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

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

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

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

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

**Management Discussion**

During the years ended December 31, 2018 and 2017, approximately 9% and 11%, 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 decreased approximately $70,000 during 2018 from 2017. There was an increase in 2018 from 2017 of approximately $129,000 in government shipments at the ATG and a decrease of approximately $199,000 in government shipments at the CPG. The Company believes that government involvement in military operations overseas will continue to have an impact on the financial results in both the Advanced Technology and Consumer Products markets. While the Company is optimistic in relation to these potential opportunities, it recognizes that sales to the government are affected by defense budgets, the foreign policies of the U.S. and other nations, the level of military operations and other factors. It is difficult to predict the impact on future financial results.

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

The ATG engages its business development efforts in its primary markets and is broadening its activities to include new domestic and foreign markets that are consistent with its core competencies. We believe our business remains particularly well positioned in the strong commercial aircraft market driven by the replacement of older aircraft with more fuel efficient alternatives and the increasing demand for air travel in emerging markets. Although the ATG backlog continues to be strong, actual scheduled shipments may be delayed/changed as a function of the Company's customers' final delivery determinations based on changes in the global economy and other factors.

The CPG continues to diversify its revenue streams with a broader government focus and new commercial channels, including the addition of national retailers, international accounts, and a direct-to-consumer business line, in response to recent and ongoing reductions in military spending. The CPG is also actively growing its custom manufacturing business to provide a wide range of metal and plastic fabrication services to a variety of consumer and industrial companies. New product development is focused on the commercialization of products with applications that span government and civilian requirements to maximize demand or that open up new lines of business entirely.

The ATG and CPG continue to respond to U.S. government procurement requests for quotes. New product development activities are ongoing along with the acquisition and development of new product lines.

See also Note 11, Business Segments, of the accompanying consolidated financial statements for information concerning business segment operating results.

## Results of Operations

The following table compares the Company's consolidated statements of income data for the years ended December 31, 2018 and 2017 ($000's omitted).

| | Years Ended December 31, | | | | 2018 vs 2017 | |
|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | Dollar | % Increase |
| | Dollars | % of Sales | Dollars | % of Sales | Change | (Decrease) |
| **Revenues:** | | | | | | |
| Advanced Technology | $ 40,415 | 84.4% | $ 32,414 | 78.2% | $ 8,001 | 24.7% |
| Consumer Products | 7,442 | 15.6% | 9,030 | 21.8% | (1,588) | (17.6)% |
| | 47,857 | 100.0% | 41,444 | 100.0% | 6,413 | 15.5% |
| | | | | | | |
| Cost of goods sold, inclusive of depreciation and amortization | 35,772 | 74.7% | 31,447 | 75.9% | 4,325 | 13.8% |
| Gross margin | 12,085 | 25.3% | 9,997 | 24.1% | 2,088 | 20.9% |
| Gross margin % | 25.3% | | 24.1% | | | |
| | | | | | | |
| Selling, general and administrative | 7,743 | 16.2% | 7,845 | 18.9% | (102) | (1.3)% |
| Interest expense | 107 | 0.2% | 77 | 0.2% | 30 | 39.0% |
| Total costs and expenses | 43,622 | 91.2% | 39,369 | 95.0% | 4,253 | 10.8% |
| | | | | | | |
| Income before income tax provision | 4,235 | 8.8% | 2,075 | 5.0% | 2,160 | 104.1% |
| | | | | | | |
| Income tax provision | 737 | 1.5% | 758 | 1.8% | (21) | (2.8)% |
| Net income | $ 3,498 | 7.3% | $ 1,317 | 3.2% | $ 2,181 | 165.6% |

### Revenue

The Company's consolidated revenues from operations increased approximately $6,413,000 or 15.5% for the twelve month period ended December 31, 2018 when compared to the same period in 2017. The increase in revenue is attributable to an increase in commercial and government shipments at the ATG offset by a decrease in commercial and government shipments at the CPG. Commercial shipments increased approximately $7,872,000 or 27.5% and government shipments increased approximately $129,000 or 3.4% at the ATG for the twelve month period ended December 31, 2018 when compared to the same period in 2017. This is offset by a decrease in commercial shipments of approximately $1,389,000 or (16.8)% and a decrease in government shipments of approximately $199,000 or (25.9)% at the CPG when compared to the same period in 2017.

The consolidated revenue increase for the year ended December 31, 2018 when compared to the same period in 2017 is attributed to the ATG with increased number units shipped of approximately $4,881,000 and average price increase and mix of product sold of approximately $3,120,000. This is offset by a decrease in revenue at the CPG due to a decrease in the number of units shipped of approximately $353,000 and average price decreases and mix of product sold of approximately $1,235,000 as compared to the same period ended December 31, 2017.

### Gross Margin

The Company's consolidated gross margin increased approximately $2,088,000 or 20.9% for the year ended December 31, 2018 when compared to the same period in 2017.

Gross margin improved in the twelve month period ended December 31, 2018 due to the increase in units shipped of approximately $1,184,000 and increased average prices and mix of product sold of approximately $1,913,000 at the ATG as compared to the same period of 2017. This is partially offset by a decrease in the average prices and mix of product sold of approximately $1,020,000 with a slight improvement of the average costs of the units shipped $11,000 at the CPG as compared to the same period of 2017.

**Selling, General and Administrative Expenses**

Selling, general and administrative (SG&A) expenses decreased approximately $102,000 or (1.3)% for the year ended December 31, 2018 compared to the same period in 2017. This is primarily driven by the decrease in non-recurring legal and pension expenses at the ATG in 2018 compared to those incurred in 2017 offset by an increase in SG&A expenses in 2018 at the CPG for sales and administrative support, sales commissions, and travel as compared to 2017.

**Interest Expense**

Interest expense increased approximately $30,000 or 39.0% primarily due to the lease line of credit for equipment financing at the ATG for the twelve month period ended December 31, 2018 compared to the same period in 2017. See also Note 4, Long-Term Debt, of the accompanying consolidated financial statements for information on long-term debt.

**Other Income**

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

**Income Taxes**

The Company's effective tax rate for operations was 17.40% in 2018 and 36.5% in 2017. The effective tax rate in both years reflects federal and state income taxes, permanent non-deductible expenditures, the deduction for domestic production activities, the deduction for foreign-derived intangible income (FDII) in 2018, and the federal tax credit for research and development expenditures. The effective tax rate was lower in 2018 primarily due to the revaluation of the deferred tax balances that occurred in 2017 as a result of a reduction in the Federal tax rate from tax law changes enacted in 2017 partially offset by permanent differences and research tax credits. See also Note 6, Income Taxes, of the accompanying consolidated financial statements for information concerning income taxes.

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of assets and liabilities, as well as net operating loss and tax credit carryforwards.

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act (the "Act"). The legislation significantly changed U.S. tax law by, among other things, changing rules related to usage and limitation of net operating loss carryforwards created in tax years beginning after December 31, 2017, implementing a territorial tax system and imposing a transition toll tax on deemed repatriated earnings of foreign subsidiaries and lowering corporate income tax rates. The Act permanently reduced the U.S. corporate income tax rate from a maximum of 35% to a 21% rate, effective January 1, 2018.

**Net Income**

Income from operations increased approximately $2,181,000 or 165.6% when comparing the twelve month period ended December 31, 2018 to the same period in 2017. This increase is the result of a pretax increased revenue partially offset by increases in cost of goods sold discussed earlier.

**Liquidity and Capital Resources**

The Company's primary liquidity and capital expenditure requirements relate to working capital needs; primarily inventory, accounts receivable, accounts payable, capital expenditures for property, plant and equipment and principal payments on debt. At December 31, 2018, the Company had working capital of approximately $23,141,000 ($21,043,000 – 2017) of which approximately $2,598,000 ($4,707,000 – 2017) was comprised of cash and cash equivalents.

The Company generated approximately $833,000 in cash from operations during the year ended December 31, 2018 as compared to $3,652,000 during the year ended December 31, 2017. Cash was generated primarily through net income of approximately $3,498,000, adjustments to reconcile net income to net cash of approximately $1,931,000 and timing of accounts payable. The primary use of cash for the Company's operating activities for the year ended December 31, 2018 include working capital requirements, mainly an increase in accounts receivables and inventories of approximately $2,183,000 and $2,464,000, respectively. Cash generated and used in operations is consistent with sales volume, customer expectations and competitive pressures.

The Company's primary use of cash in its financing and investing activities in the year ended December 31, 2018 included approximately $708,000 of current principal payments on long-term debt, approximately $403,000 for cash dividends as well as approximately $175,000 for the purchase of treasury shares. The Company also expended approximately $1,656,000, net of proceeds from equipment financing, for capital expenditures.

On December 1, 2014, the Company, entered into a Loan Agreement that provides for a $2,620,000 seven-year term loan (the "Term Loan") and $2,000,000 line of credit (the "Line of Credit"). The Company renewed a $2,000,000 line of credit available until June 19, 2019 unless subsequently renewed. As of December 31, 2018, there were no draws on the line. The proceeds from the Term Loan were used to pay off the Industrial Development Revenue Bonds that were issued by a government agency in 1994 to finance the construction of the Company's headquarters/advanced technology facility and which matured on December 1, 2014.

In addition, the Company's wholly-owned subsidiary, The Ontario Knife Company (OKC) entered into a separate Loan Agreement with the Bank on December 1, 2014. The OKC Loan Agreement provides for a $2,000,000 seven-year term loan (the "OKC Term Loan"). The proceeds from the OKC Term Loan were used to purchase equipment and expand/renovate the OKC facility in Franklinville, New York.

Borrowings under these Credit Facilities bear interest, at the Company's option, at the Bank's Prime Rate or LIBOR plus 1.4%. Principal installments are payable on the Company's Term Loan and the OKC Term Loan through December 1, 2021 with a balloon payment of $786,000 at maturity of the Company's Term Loan. The Term Loan and Line of Credit are secured by all of the Company's equipment, receivables and inventory. The OKC Term Loan is secured by substantially all of OKC's equipment and is fully and unconditionally guaranteed by the Company.

The Company established a lease line of credit for equipment financing in the amount of $1,000,000 available until June 28, 2018. The lease term for equipment covered by the lease line of credit is sixty months. Monthly payments are fixed for the term of each funding based upon the Lender's lease pricing in effect at the time of such funding. There was approximately $704,000 outstanding at December 31, 2018.

The Company believes its cash generating capability and financial condition, together with available credit facilities will be adequate to meet our future operating, investing and financing needs.

**Off Balance Sheet Arrangements**

Not applicable.

**Critical Accounting Policies**

The Company prepares its consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP). As such, the Company is 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. Note 1, Business Description and Summary of Significant Accounting Policies, of the accompanying consolidated financial statements includes a summary of the significant accounting policies used in the preparation of the consolidated financial statements.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

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

**Item 8. Financial Statements and Supplementary Data**

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

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

**Item 9A. Controls and Procedures**

**(i) Disclosure Controls and Procedures**

The Company carried out an evaluation under the supervision and with the participation of its management, including the Company's Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") of the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of December 31, 2018. Based upon that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in SEC reports under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company's management, including the CEO and CFO as appropriate to allow timely decisions regarding required disclosure.

**(ii) Management's Report on Internal Control over Financial Reporting**

The Company's management is responsible for establishing and maintaining adequate internal controls over financial reporting (as defined in Exchange Act Rule 13a-15(f)). Under the supervision and with the participation of management, including the CEO and CFO, the Company, conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. Based on the Company's evaluation under the framework, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2018.

**(iii) Changes in Internal Control Over Financial Reporting**

There were no changes in the Company's internal controls over financial reporting during the fourth quarter of 2018 that have materially affected, or are reasonably likely to affect, the Company's internal controls over financial reporting.

**Item 9B. Other Information**

Not applicable.

## PART III

### Item 10. Directors, Executive Officers and Corporate Governance

Information regarding directors and executive officers of the Company, compliance with Section 16(a) of the Securities Exchange Act and the Company's Audit Committee, its members and the Audit Committee financial expert, is incorporated herein by reference to the information included in the Company's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Company's 2018 fiscal year or such information will be included by amendment to this Form 10-K.

**Code of Ethics**

The Company has adopted a Code of Ethics and Business Conduct (the Code) that applies to all directors, officers and employees of the Company as required by the listing standards of the NYSE American. 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 NYSE American.

### Item 11. Executive Compensation

Information regarding executive compensation is incorporated herein by reference to the information included in the Company's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Company's 2018 fiscal year or such information will be included by amendment to this Form 10-K.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

**Securities Authorized for Issuance Under Equity Compensation Plans**

The following table sets forth the securities authorized for issuance under the Company's equity compensation plans as of December 31, 2018:

| Plan category | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options warrants and rights | Number of securities remaining available for future issuance under equity compensation plans |
|---|---|---|---|
| Equity compensation plans approved by security holders | - | - | 89,409 |
| Equity compensation plans not approved by security holders | - | - | - |
| Total | - | - | 89,409 |

Information regarding security ownership of certain beneficial owners and management is incorporated herein by reference to the information included in the Company's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Company's 2018 fiscal year or such information will be included by amendment to this Form 10-K.

Also incorporated by reference is the information in the table under the heading "Company Purchases of Company's Equity Securities" included in Item 5 of this Form 10-K. See also Note 7, Shareholders' Equity, of the accompanying consolidated financial statements for more information.

### Item 13. Certain Relationships and Related Transactions and Director Independence

Information regarding certain relationships and related transactions and director independence is incorporated herein by reference to the information included in the Company's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Company's 2018 fiscal year or such information will be included by amendment to this Form 10-K.

### 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 Company's definitive proxy statement if it is filed with the Commission within 120 days after the end of the Company's 2018 fiscal year or such information will be included by amendment to this Form 10-K.

## PART IV

**Item 15. The information contained in Part IV (except for the list of Exhibits and Signatures) is contained in the Company's Proxy Statement.**

### FORWARD-LOOKING STATEMENTS

In addition to historical information, certain sections of this Form 10-K 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, planned growth efforts and expectation of new business and success in its entry into new product programs. Forward-looking statements involve numerous risks and uncertainties. The Company derives a material portion of its revenues from fixed price contracts with agencies of the U.S. Government or their prime contractors. 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, including political risks, adverse changes in legal and regulatory environments, and difficulty in predicting defense appropriations, the introduction of new technologies and the impact of competitive products, 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 Company’s ability to accurately align capacity with demand, the availability of financing and changes in interest rates, the outcome of pending and potential litigation and the additional risk factors discussed elsewhere in this Form 10-K and in the Company’s filings with the Securities and Exchange Commission. 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, whether as a result of new information, future events or otherwise.

**SERVOTRONICS, INC. AND SUBSIDIARIES**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**



Consolidating financial statement schedules are omitted because they are not applicable to smaller reporting companies.

FreedMaxick CPAs, P.C.

**Report of Independent Registered Public Accounting Firm**

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

**Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheets of Servotronics, Inc. and Subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of income, consolidated statements of comprehensive income, and consolidated statements of cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Freed Maxick CPAs, P.C.

We have served as the Corporation's auditor since 2005.

Buffalo, New York
March 14, 2019

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

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| **Current assets:** | | |
| Cash and cash equivalents | $ 2,598 | $ 4,707 |
| Accounts receivable, net | 10,586 | 8,424 |
| Inventories, net | 15,150 | 12,791 |
| Prepaid income taxes | 314 | - |
| Other current assets | 496 | 249 |
| Total current assets | 29,144 | 26,171 |
| Property, plant and equipment, net | 11,875 | 11,021 |
| Deferred income taxes | 295 | 409 |
| Other non-current assets | 371 | 385 |
| **Total Assets** | $ 41,685 | $ 37,986 |
| **Liabilities and Shareholders' Equity** | | |
| **Current liabilities:** | | |
| Current portion of long-term debt | $ 548 | $ 548 |
| Current portion of capitalized lease obligations | 175 | 133 |
| Dividend payable | 13 | - |
| Accounts payable | 2,494 | 1,377 |
| Accrued employee compensation and benefits costs | 1,908 | 1,784 |
| Accrued income taxes | - | 414 |
| Other accrued liabilities | 865 | 872 |
| Total current liabilities | 6,003 | 5,128 |
| Long-term debt | 2,410 | 2,950 |
| Post retirement obligation | 1,759 | 1,743 |
| **Shareholders' equity:** | | |
| Common stock, par value $0.20; authorized 4,000,000 shares; issued 2,614,506 shares; outstanding 2,392,207 (2,308,315 - 2017) shares | 523 | 523 |
| Capital in excess of par value | 14,250 | 14,171 |
| Retained earnings | 18,788 | 15,709 |
| Accumulated other comprehensive income (loss) | 35 | (32) |
| Employee stock ownership trust commitment | (561) | (662) |
| Treasury stock, at cost 117,979 (183,983 - 2017) shares | (1,522) | (1,544) |
| Total shareholders' equity | 31,513 | 28,165 |
| **Total Liabilities and Shareholders' Equity** | $ 41,685 | $ 37,986 |

See notes to consolidated financial statements

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

| | Years Ended | |
|---|---|---|
| | **December 31, 2018** | **December 31, 2017** |
| **Revenue** | $ 47,857 | $ 41,444 |
| **Costs of goods sold, inclusive of depreciation and amortization** | 35,772 | 31,447 |
| **Gross margin** | 12,085 | 9,997 |
| **Operating expenses:** | | |
| Selling, general and administrative | 7,743 | 7,845 |
| Interest expense | 107 | 77 |
| Total operating expenses | 7,850 | 7,922 |
| **Income before income tax provision** | 4,235 | 2,075 |
| Income tax provision | 737 | 758 |
| **Net income** | $ 3,498 | $ 1,317 |
| **Income per share:** | | |
| **Basic** | | |
| Net income per share | $ 1.54 | $ 0.58 |
| **Diluted** | | |
| Net income per share | $ 1.49 | $ 0.57 |

See notes to consolidated financial statements

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

| | Years Ended December 31, 2018 | Years Ended December 31, 2017 |
|---|---|---|
| **Net Income** | $ 3,498 | $ 1,317 |
| Other comprehensive income (loss): | | |
| Retirement benefits adjustment, net of income taxes | 67 | (12) |
| **Total comprehensive income** | $ 3,565 | $ 1,305 |

See notes to consolidated financial statements

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

| | Years Ended December 31, 2018 | Years Ended December 31, 2017 |
|---|---|---|
| **Cash flows related to operating activities:** | | |
| Net Income | $ 3,498 | $ 1,317 |
| Adjustments to reconcile net income to net cash generated in operating activities: | | |
| Depreciation and amortization | 1,025 | 885 |
| Loss on disposal of property | 1 | 16 |
| Stock based compensation | 276 | 213 |
| Increase in allowance for doubtful accounts | 21 | 77 |
| Increase in inventory reserve | 105 | 88 |
| Increase in warranty reserve | 389 | 39 |
| Deferred income tax | 114 | 82 |
| **Change in assets and liabilities:** | | |
| Accounts receivable | (2,183) | (1,062) |
| Inventories | (2,464) | 414 |
| Prepaid income taxes | (314) | 182 |
| Other current assets | (247) | 138 |
| Other non-current assets | - | (9) |
| Accounts payable | 1,117 | (703) |
| Accrued employee compensation and benefit costs | 124 | 575 |
| Other accrued liabilities | (399) | 406 |
| Accrued income taxes | (414) | 414 |
| Post retirement obligation | 83 | 479 |
| Employee stock ownership trust payment | 101 | 101 |
| **Net cash generated by operating activities** | 833 | 3,652 |
| **Cash flows related to investing activities:** | | |
| Capital expenditures - property, plant and equipment | (1,866) | (2,176) |
| Proceeds from sale of assets | - | 180 |
| **Net cash used by investing activities** | (1,866) | (1,996) |
| **Cash flows related to financing activities:** | | |
| Principal payments on long-term debt | (548) | (547) |
| Principal payments on capital lease obligations | (160) | (14) |
| Proceeds from capital leases | 210 | 668 |
| Purchase of treasury shares | (175) | (195) |
| Cash dividend | (403) | (376) |
| **Net cash used by financing activities** | (1,076) | (464) |
| Net (decrease)/increase in cash and cash equivalents | (2,109) | 1,192 |
| Cash and cash equivalents at beginning of year | 4,707 | 3,515 |
| **Cash and cash equivalents at end of year** | $ 2,598 | $ 4,707 |

See notes to consolidated financial statements

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## 1. Business Description and Summary of Significant Accounting Policies

### Business Description

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

### Principles of Consolidation

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

### Cash and Cash Equivalents

The Company considers cash and cash equivalents to include all checking, savings and money market accounts.

### Accounts Receivable

The Company grants credit to substantially all of its customers and carries its accounts receivable at original invoice amount less an allowance for doubtful accounts. On a periodic basis, the Company evaluates its accounts receivable and establishes an allowance for doubtful accounts based on history of past write-offs, collections, and current credit conditions. The allowance for doubtful accounts amounted to approximately $170,000 at December 31, 2018 and $149,000 at December 31, 2017. The Company does not accrue interest on past due receivables.

### Revenue Recognition

Revenues are recognized at the time of shipment of goods, transfer of title and customer acceptance, as required. Our revenue transactions generally consist of a single performance obligation to transfer contracted goods and are not accounted for under industry-specific guidance. 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. Service sales, principally representing repair, are recognized at the time of shipment of goods.

The costs incurred for nonrecurring engineering, development and repair activities of our products under agreements with commercial customers are expensed as incurred. Subsequently, the revenue is recognized as products are delivered to the customers with the approval by the customers.

Revenue is recognized at an amount that reflects the consideration to which the Company expects to be entitled in exchange for transferring goods and services to a customer. The Company determines revenue recognition using the following five steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when the company satisfies a performance obligation.

Revenue excludes taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the Company from a customer (e.g., sales and use taxes). Revenue includes payments for shipping activities that are reimbursed by the customer to the Company.

Revenue on a significant portion of our contracts is currently recognized at the time of shipment of goods, transfer of title and customer acceptance, as required. Our revenue transactions generally consist of a single performance obligation to transfer contracted goods and are not accounted for under industry-specific guidance.

Performance obligations are satisfied as of a point in time. Performance obligations are supported by contracts with customers, providing a framework for the nature of the distinct goods, services or bundle of goods and services. The timing of satisfying the performance obligation is typically indicated by the terms of the contract. As a significant portion of the Company's revenue are recognized at the time of shipment, transfer of title and customer acceptance, there is no significant judgment applied to determine the timing of the satisfaction of performance obligations or transaction price.

The timing of satisfaction of our performance obligations does not significantly vary from the typical timing of payment. The Company generally receives payment for these contracts within the payment terms negotiated and agreed upon by each customer contract.

Warranty and repair obligations are assessed on all returns. Revenue is not recorded on any warranty returns. The Company warrants its products against design, materials and workmanship based on an average of twenty-seven months. The Company determines warranty reserves needed based on actual average costs of warranty units shipped and current facts and circumstances. As of December 31, 2018 and December 31, 2017 under the guidance of ASC460 the Company has recorded a warranty reserve of approximately $428,000 and $39,000, respectively. This amount is reflected in other accrued expenses in the accompanying balance sheet. Revenue is recognized on repair returns, covered under a customer contract, at the contractual price upon shipment to the customer.

**Inventories**

Inventories are stated at the lower of cost or net realizable value. Cost includes all costs incurred to bring each product to its present location and condition. Market provisions in respect of lower of cost or market adjustments and inventory expected to be used in greater than two years are applied to the gross value of the inventory through a reserve of approximately $1,543,000 and $1,438,000 at December 31, 2018 and December 31, 2017, respectively. Pre-production and start-up costs are expensed as incurred.

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

**Shipping and Handling Costs**

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

**Property, Plant and Equipment**

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

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

| | |
|---|---|
| Buildings and improvements | 5-40 years |
| Machinery and equipment | 5-20 years |
| Tooling | 3-5 years |

**Income Taxes**

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

The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company did not have any accrued interest or penalties included in its consolidated balance sheets at December 31, 2018 or December 31, 2017, and did not recognize any interest and/or penalties in its consolidated statements of income during the years ended December 31, 2018 and 2017. The Company did not have any material uncertain tax positions or unrecognized tax benefits or obligations as of December 31, 2018 and December 31, 2017. The 2015 through 2017 federal and state tax returns remain subject to examination.

**Supplemental Cash Flow Information**

Income taxes paid during the twelve month periods ended December 31, 2018 and 2017 amounted to approximately $1,325,000 and $73,000, respectively. Interest paid during the twelve month periods ended December 31, 2018 and 2017 amounted to approximately $107,000 and $77,000, respectively.

**Employee Stock Ownership Plan**

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

**Impairment of Long-Lived Assets**

The Company reviews long-lived assets for impairment annually or 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. Due to the losses incurred by our CPG segment, we performed a test for recoverability of the long-lived assets by comparing its carrying value to the future undiscounted cash flows that we expect will be generated by the asset group. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal. The Company has determined that no impairment of long-lived assets existed at December 31, 2018 and December 31, 2017.

**Use of Estimates**

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

**Reclassifications**

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

**Research and Development Costs**

Research and development costs are expensed as incurred.

**Concentration of Credit Risks**

Financial instruments that potentially subject the Company to concentration of credit risks principally consist of cash accounts in financial institutions. Although the accounts exceed the federally insured deposit amount, management does not anticipate nonperformance by the financial institutions.

During the Company's 2018 fiscal year, sales of advanced technology products pursuant to contracts with prime or subcontractors for various branches of the United States Government accounted for approximately 8% of the Company's consolidated revenues as compared to 9% in 2017. The Company had sales of advanced technology products to three customers, including various divisions and subsidiaries of a common parent company, which represented more than 10% of consolidated revenues in 2018. Total revenues from these three customers amounted to approximately 62% in 2018 as compared to three customers amounting to approximately 49% of the Company's consolidated revenues in 2017. No other customers of the ATG or CPG represented more than 10% of the Company's consolidated revenues in either of these years. Refer to Note 11, Business Segments, for disclosures related to business segments of the Company.

**Fair Value of Financial Instruments**

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

**Recent Accounting Pronouncements Adopted**

Effective January 1, 2018 the Company adopted ASU 2017-07, "Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," issued by the Financial Accounting Standards Board (FASB) which requires employers to present the service cost component of net periodic benefit cost in the same income statement line item(s) as other employee compensation costs arising from services rendered during the period. Only the service cost component will be eligible for capitalization in assets. The other components of net periodic benefit cost will be presented separately from the line item(s) that includes the service cost and outside of any subtotal of operating income, if one is presented. ASU 2017-07 allows a practical expedient that permits an entity to use amounts disclosed in its pension and other post retirement requirements. The Company adopted this guidance during the reporting period. The reporting of the annual service costs is immaterial.

Effective January 1, 2018, the Company adopted ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" using the modified retrospective method. The new revenue recognition standard outlines a comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. Topic 606 also requires significantly expanded disclosure requirements and applied the standard to all contracts that were not completed as of January 1, 2018. There was no cumulative effect of the adoption recognized. We have obtained an understanding of the new standard and determined that the Company will retain much of the same accounting treatment used to recognize revenue as compared to prior standards. See above for the Company's updated revenue recognition accounting policy.

Effective January 1, 2018, the Company adopted ASU 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" that allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the U.S. tax reform legislation commonly known as the Tax Cuts and Jobs Act of 2017. This guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The Company applied the guidance as of the beginning of the period of adoption and reclassified approximately $6,000 from accumulated other comprehensive loss to retained earnings due to the change in the federal corporate tax rate.

**Recent Accounting Pronouncements Not Yet Adopted**

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." There are elements of the new standard that could impact almost all entities to some extent, although the lessees will likely see the most significant changes. Lessee will need to recognize virtually all of their leases on the balance sheet, by recording the right-of-use asset and a lease liability. Public business entities are required to adopt the new leasing standard for fiscal years, and interim period within those fiscal years, beginning December 15, 2018. For calendar year-end public companies, this means an adoption date of January 1, 2019. Early adoption is permitted. The Company does not believe the adoption will have a material impact on the financial statements and disclosures.

**2. Inventories**

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| | ($000's omitted) | |
| Raw material and common parts | $ 9,088 | $ 8,375 |
| Work-in-process | 5,123 | 2,940 |
| Finished goods | 2,482 | 2,914 |
| | 16,693 | 14,229 |
| Less inventory reserve | (1,543) | (1,438) |
| Total inventories | $ 15,150 | $ 12,791 |

**3. Property, Plant and Equipment**

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| | ($000's omitted) | |
| Land | $ 7 | $ 7 |
| Buildings | 10,452 | 10,288 |
| Machinery, equipment and tooling | 18,345 | 17,249 |
| Construction in progress | 1,258 | 665 |
| | 30,062 | 28,209 |
| Less accumulated depreciation and amortization | (18,187) | (17,188) |
| Total property, plant and equipment | $ 11,875 | $ 11,021 |

Depreciation and amortization expense amounted to approximately $1,025,000 and $885,000 for the year ended December 31, 2018 and 2017, respectively. Depreciation expense amounted to approximately $948,000 and $872,000 for the year ended December 31, 2018 and 2017, respectively. Amortization expense primarily related to capital leases amounted to approximately $77,000 and $13,000 for the year ended December 31, 2018 and 2017, respectively. The Company maintains property and casualty insurance in amounts adequate for the risk and nature of its assets and operations and which are generally customary in its industry.

As of December 31, 2018, there is approximately $1,258,000 ($665,000 – 2017) of construction in progress (CIP) included in property, plant and equipment all of which is related to capital projects. There is approximately $719,000 in CIP for the implementation costs for the enterprise resource planning software that will be used as an integral part of the product process at the Advanced Technology Group (“ATG”) and the Consumer Products Group (“CPG”) and approximately $154,000 for machinery received but not placed in service at both the ATG and CPG with the remainder of approximately $385,000 of self-constructed assets not yet put into service.

**4. Long-Term Debt**

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| | ($000's omitted) | |
| Term loan payable to a financial institution; Interest rate option of bank prime or Libor plus 1.4% (3.7492% as of December 31, 2018), monthly prinicipal payments of $21,833 through 2021 with a balloon payment of $786,000 due December 1, 2021 | $ 1,572 | $ 1,835 |
| Term loan payable to a financial institution; Interest rate option of bank prime or Libor plus 1.4% (3.7492% as of December 31, 2018), monthly prinicipal payments of $23,810 through December 1, 2021 | 857 | 1,142 |
| Lease line of credit for equipment; Interest rate fixed for term of of each funding based upon the Lender's lease pricing at time of funding. (Interest rate/factor 1.822758% - 1.869304% at time of funding) | 704 | 654 |
| | 3,133 | 3,631 |
| Less current portion | (723) | (681) |
| | $ 2,410 | $ 2,950 |

Principal maturities of long-term debt are as follows: 2019 - $723,000, 2020 - $723,000, 2021 - $1,509,000, 2022 - $165,000, and 2023 - $13,000.

The Company also has a $2,000,000 line of credit on which there was no balance outstanding at December 31, 2018 and December 31, 2017. The interest rate is a rate per year equal to the bank's prime rate or Libor plus 1.4%.

The term loans and line of credit are secured by all personal property of the Company with the exception of certain equipment that was purchased from proceeds of government grants.

Certain lenders require the Company to comply with debt covenants as described in the specific loan documents, including a debt service ratio. At December 31, 2018 and December 31, 2017 the Company was in compliance with these covenants.

The Company established a lease line of credit for equipment financing in the amount of $1,000,000 with initial borrowings available until June 28, 2018. The lease term for equipment covered by the lease line of credit is sixty months. Monthly payments are fixed for the term of each funding based upon the Lender's lease pricing in effect at the time of such funding. Each lease is secured by the underlying equipment.

Remaining principal payments for the capital lease obligations for each of the next five years:

| | | December 31, 2018 ($000's omitted) |
|---|---|---|
| | 2019 | 193 |
| | 2020 | 193 |
| | 2021 | 193 |
| | 2022 | 193 |
| | 2023 | 4 |
| Total principal payments | | 776 |
| Less amount representing interest | | (72) |
| Present value of net minimum lease payments | | 704 |
| Less current portion | | (175) |
| Long term principle payments | | $ 529 |

## 5. Employee Benefit Plans

### Employee Stock Ownership Plan (ESOP)

In 1985, the Company established an employee stock ownership plan (ESOP) for the benefit of employees who meet certain minimum age and 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 those under the Company's original loan.

ESOP shares are held by the plan trustees in a suspense account until allocated to participant accounts. Each year the Company makes contributions to the trust sufficient to enable the trust to repay the principal and interest due to the Company under the trust loans. As the loans are repaid, shares are released from the suspense account pro rata based on the portion of the aggregate loan payments that are paid during the year. During 2010, the ESOP plan was amended to allow dividends on unallocated shares to be distributed to participants in cash, unless otherwise directed. ESOP shares released from the suspense account are allocated to participants on the basis of their relative compensation in the year of allocation and/or on the participant's account balance. For this purpose, "compensation" means taxable pay.

If Servotronics shares are not readily tradable on an established securities market at the times of an ESOP participant's termination of employment or retirement and if such ESOP participant requests that his/her ESOP distributed shares be repurchased by the Company, the Company is obligated to do so. The Company's shares currently trade on NYSE American, formerly known as the American Stock Exchange. There were no outstanding shares subject to the repurchase obligation at December 31, 2018.

Since inception of the ESOP, 416,312 shares have been allocated, exclusive of shares distributed to ESOP participants. At December 31, 2018 and 2017, 104,320 and 122,208 shares, respectively, 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 approximately $101,000 in both 2018 and 2017. Included as a reduction to shareholders' equity is the ESOP 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.

**Other Postretirement Benefit Plans**

The Company provides certain postretirement health and life insurance benefits for the Company's Chief Executive Officer. Upon retirement and after attaining at least the age of 65, the Company will pay the annual cost of health insurance for the retired executive and his dependents and will continue the Company provided life insurance offered at the time of retirement. The retiree's health insurance benefits ceases upon the death of the retired executive. The actuarially calculated future obligation of the benefits at December 31, 2018 and 2017 is approximately $644,000 and $736,000, respectively, excluding the estimated liability related to postretirement benefits for the former Executive Officer discussed in Note 8, Commitments and Contingencies. Additional expense of approximately $100,000 per year is expected to be paid subsequent to December 31, 2018 under the Plan. Estimated future annual expenses associated with the plan are immaterial. Included in accumulated other comprehensive income (loss) for 2018 and 2017 is approximately $67,000 and $(12,000), respectively, net of deferred taxes, associated with the unrecognized service cost of the plan.

## 6. Income Taxes

The income tax provision (benefit) from operations included in the consolidated statements of income consists of the following:

| | Years Ended December 31, 2018 | Years Ended December 31, 2017 |
|---|---|---|
| | ($000's omitted) | |
| Current: | | |
| Federal | $ 639 | $ 675 |
| State | 2 | 1 |
| | 641 | 676 |
| Deferred: | | |
| Federal | 96 | 82 |
| State | - | - |
| | 96 | 82 |
| | $ 737 | $ 758 |

The reconciliation of the federal statutory income tax rate to the Company's effective tax rate based upon the total income tax provision from operations is as follows:

| | Years Ended | |
|---|---|---|
| | **December 31, 2018** | **December 31, 2017** |
| Federal statutory rate | 21.0% | 34.0% |
| Business credits | -0.6% | -4.8% |
| ESOP dividend | -0.4% | -1.4% |
| Stock compensation | -0.4% | -1.9% |
| Domestic production activities deduction | -0.4% | -2.4% |
| Revaluation of deferred taxes for federal tax rate change | 0.0% | 12.6% |
| Foreign-derived intangible income deduction | -1.8% | 0.0% |
| Other | 0.0% | 0.4% |
| | 17.4% | 36.5% |

At December 31, 2018 and 2017, the deferred tax assets (liabilities) were comprised of the following:

| | Years Ended | |
|---|---|---|
| | **December 31, 2018** | **December 31, 2017** |
| | **($000's omitted)** | |
| Deferred Tax Assets: | | |
| Inventories | $ 417 | $ 406 |
| Accrued employees compensation and benefits costs | 478 | 430 |
| Accrued arbitration award and related liability | 234 | 268 |
| Net operating loss and credit carryforwards | 248 | 269 |
| Bad debt reserve | 37 | 33 |
| Warranty reserve | 90 | 8 |
| Other | - | 33 |
| Minimum pension liability | - | 9 |
| Total deferred tax assets | 1,504 | 1,456 |
| Valuation allowance | (248) | (279) |
| Net deferred tax asset | 1,256 | 1,177 |
| | | |
| Deferred tax liabilities: | | |
| Prepaid expenses | (28) | - |
| Property, plant and equipment | (910) | (768) |
| Other | (14) | - |
| Minimum pension liability | (9) | - |
| Total deferred tax liabilities | (961) | (768) |
| Net deferred tax asset | $ 295 | $ 409 |

In assessing the ability of the Company to realize the benefit of the deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based upon the level of historical taxable income, the opportunity for net operating loss carrybacks, and projections for future taxable income over the periods which deferred tax assets are deductible, management believes it is more likely than not the Company will generate sufficient taxable income to realize the benefits of these deductible differences at December 31, 2018, except for a valuation allowance of $248,000 ($279,000 – 2017) related to certain state net operating loss carryforwards, state tax credit carryforwards and other state net deferred tax assets. At December 31, 2018, the Company has net operating loss carryforwards with full valuation allowances from Pennsylvania of approximately $1,805,000 ($2,240,000 – 2017), which begin to expire in 2019, and Arkansas of approximately $31,000 ($31,000 – 2017), which begin to expire in 2019, respectively. The Company also has a New York state tax credit carryforward at December 31, 2018 of approximately $131,000 ($115,000 – 2017), which begins to expire in 2023.

There are no uncertain tax positions or unrecognized tax benefits for 2018 and 2017. The Company is subject to routine audits of its tax returns by the Internal Revenue Service and various state taxing authorities. The 2015 through 2017 Federal and state tax returns remain subject to examination.

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act (the “Act”). The legislation significantly changed U.S. tax law by, among other things, changing rules related to usage and limitation of net operating loss carryforwards created in tax years beginning after December 31, 2017, implementing a territorial tax system and imposing a transition toll tax on deemed repatriated earnings of foreign subsidiaries and lowering corporate income tax rates. The Act permanently reduced the U.S. corporate income tax rate from a maximum of 35% to a 21% rate, effective January 1, 2018.

## 7. Shareholders' Equity

| | Common Stock | | ($000's omitted except for share data) | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Number of shares issued | Amount | Capital in excess of par value | Retained earnings | ESOT | Treasury stock | Accumulated Other Comprehensive Income (Loss) | Total shareholders' equity |
| Balance at December 31, 2016 | 2,614,506 | $ 523 | $ 14,160 | $ 14,768 | $ (763) | $ (1,551) | $ (20) | $ 27,117 |
| Net income | - | - | - | 1,317 | - | - | - | 1,317 |
| Retirement benefits adjustment | - | - | - | - | - | - | (12) | (12) |
| Compensation expense | - | - | - | - | 101 | - | - | 101 |
| Purchase of treasury shares | - | - | - | - | - | (195) | | (195) |
| Cash dividend | - | - | - | (376) | - | - | - | (376) |
| Stock based compensation net of tax benefit | - | - | 11 | - | - | 202 | - | 213 |
| Balance at December 31, 2017 | 2,614,506 | $ 523 | $ 14,171 | $ 15,709 | $ (662) | $ (1,544) | $ (32) | $ 28,165 |
| Net income | - | - | - | 3,498 | - | - | - | 3,498 |
| Retirement benefits adjustment | - | - | - | - | - | - | 67 | 67 |
| Compensation expense | - | - | - | - | 101 | - | - | 101 |
| Purchase of treasury shares | - | - | - | - | - | (175) | | (175) |
| Cash dividend | - | - | - | (413) | - | - | - | (413) |
| Stock based compensation net of tax benefit | - | - | 79 | (6) | - | 197 | - | 270 |
| Balance at December 31, 2018 | 2,614,506 | $ 523 | $ 14,250 | $ 18,788 | $ (561) | $ (1,522) | $ 35 | $ 31,513 |

The Company's Board of Directors authorized the purchase of up to 450,000 shares of its common stock in the open market or in privately negotiated transactions. As of December 31, 2018, the Company has purchased 355,023 shares and there remain 94,977 shares available to purchase under this program. There were 5,693 shares purchased by the Company in 2018.

On January 1, 2018, 28,500 shares of restricted stock vested of which 11,341 shares were withheld and repurchased by the Company for approximately $117,000 to satisfy statutory minimum withholding tax requirements for those participants who elected this option as permitted under the Company's 2012 Long-Term Incentive Plan.

On May 25, 2018, the Company issued 78,750 shares of restricted stock to Executive Officers and certain key management of the Company under the Company's 2012 Long-Term Incentive Plan. The restricted share awards have varying vesting periods between January 2019 and January 2021; however, these shares have voting rights and accrue dividends prior to vesting. The accrued dividends are paid upon vesting of the restricted shares. The aggregate amount of expense to the Company, measured based on grant date fair value is expected to be approximately $735,000 and will be recognized over the requisite service period.

On May 25, 2018, the Company revised its director compensation policy pursuant to which non-employee directors receive a portion of their annual retainer in the form of restricted stock under the Company's 2012 Long-Term Incentive Plan. An aggregate of 4,288 restricted shares were issued that vest quarterly over a twelve month service period. These shares have voting rights and accrue dividends that are paid upon vesting. The aggregate amount of expense to the Company, measured based on the grant date fair value is expected to be approximately $40,000 and will be recognized over the requisite service period.

Included in the year ended December 31, 2018 and 2017 is approximately $276,000 and $213,000, respectively, of stock-based compensation expense related to the restrictive share awards.

On May 18, 2018 the Company announced that its Board of Directors declared a $0.16 per share cash dividend ($0.15 per share cash dividend in 2017). The dividend was subsequently paid on July 16, 2018 to shareholders of record on June 30, 2018 and was approximately $416,000 in the aggregate ($376,000 – 2017). These dividends do not represent that the Company will pay dividends on a regular or scheduled basis. The amount was recorded in dividends payable and as a reduction to retained earnings on the accompanying consolidated balance sheet.

**Earnings Per Share**

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period. The weighted average number of common shares outstanding does not include any potentially dilutive securities or any unvested restricted shares of common stock. These unvested restricted shares, although classified as issued and outstanding, are considered forfeitable until the restrictions lapse and will not be included in the basic EPS calculation until the shares are vested. Diluted earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period plus the number of shares of common stock that would be issued assuming all contingently issuable shares having a dilutive effect on the earnings per share that were outstanding for the period. The dilutive effect of unvested restrictive stock is determined using the treasury stock method.

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| | ($000's omitted except for per share data) | |
| Net Income | $ 3,498 | $ 1,317 |
| Weighted average common shares outstanding (basic) | 2,272 | 2,267 |
| Unvested restricted stock | 81 | 29 |
| Weighted average common shares outstanding (diluted) | 2,353 | 2,296 |
| Basic | | |
| Net income per share | $ 1.54 | $ 0.58 |
| Diluted | | |
| Net income per share | $ 1.49 | $ 0.57 |

**Share Based Payments**

The Company's 2012 Long-Term Incentive Plan was approved by the shareholders at the 2012 Annual Meeting of Shareholders. This plan authorizes the issuance of up to 300,000 shares. As of December 31, 2018, there is no unrecognized compensation related to the unvested restricted shares vested on January 1, 2019.

A summary of the status of restricted share awards granted under all employee plans is presented below:

| | Shares | | Weighted Average Grant Date Fair Value |
|---|---|---|---|
| Restricted Share Activity: | | | |
| Unvested at December 31, 2016 | 83,250 | $ | 8.02 |
| Granted in 2017 | - | $ | - |
| Forfeited in 2017 | - | $ | - |
| Vested in 2017 | 54,750 | $ | 8.09 |
| Unvested at December 31, 2017 | 28,500 | $ | 7.96 |
| Granted in 2018 | 83,038 | | 9.33 |
| Forfeited in 2018 | - | | - |
| Vested in 2018 | 30,644 | $ | 8.06 |
| Unvested at December 31, 2018 | 80,894 | $ | 9.33 |

**Shareholders' Rights Plan**

During 2012, 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 October 15, 2012. The Rights Plan replaced a previous shareholders rights plan that was adopted in 2002 and expired on August 28, 2012. 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, Kenneth 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 and Contingencies**

*Post retirement obligation.* As previously disclosed in filings with the Securities and Exchange Commission ("SEC"), the Company, under an employment agreement, is expected to pay post-employment health related benefits to a former Executive Officer of the Company (the "Former Employee"), of which approximately $1,115,000 and $1,007,000 has been accrued as of December 31, 2018 and December 31, 2017, and is reflected as Post Retirement Obligation in the accompanying balance sheet. After termination of the Former Employee, the scope of the health related benefits coverage in the agreement became an issue. In June 2016 an Arbitrator was selected by the parties to hear this matter. The Company did not consider the risk of loss to be probable at June 30, 2016, however, a final opinion and award was issued on March 22, 2018 resulting in the increased accrual at March 31, 2018. Additionally, the Company paid approximately $367,000 in fees, comprised of $304,000 in legal fees, $54,000 in health related costs, and $9,000 in interest costs pursuant to the arbitration award as of December 31, 2018.

*Employment Agreements.* The Company provides certain post-employment health and life insurance benefits for its Chief Executive Officer and President Kenneth Trbovich. Upon retirement and after attaining at least the age of 65, the Company will pay for the retired Executive's and dependent's health benefits and will continue the Company-provided life insurance offered at the time of retirement. The retiree's health insurance benefits ceases upon the death of the retired executive. Approximately $644,000 and $736,000 has been accrued as of December 31, 2018 and December 31, 2017, respectively, and is reflected as Post Retirement Obligation in the accompanying balance sheet.

**9. Litigation**

*Litigation.* The Company has pending litigation relative to leases of certain equipment and real property with a former subsidiary, Aero, Inc. Aero, Inc. is suing Servotronics, Inc. and its wholly owned subsidiary and has alleged damages in the amount of $3,000,000. The Company has filed a response to the Aero, Inc. lawsuit and has also filed a counter-claim in the amount of $3,191,000. The Company considers the risk of loss remote. Accordingly, no gain or loss has been recognized in the accompanying financials statements related to this litigation.

There are no other legal proceedings currently pending by or against the Company other than ordinary routine litigation incidental to the business which is not expected to have a material adverse effect on the business or earnings of the Company.

**10. Related Party Transactions**

The Company paid legal fees and disbursements of approximately $141,000 and $205,000 in the year ended December 31, 2018 and 2017, respectively, for services provided by a law firm that is owned by a member of the Company's Board of Directors. Additionally, the Company had accrued unbilled legal fees at December 31, 2018 and 2017 of approximately $19,000 and $47,000, respectively, with this firm.

**11. Business Segments**

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

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

| | ATG | | CPG | | Consolidated | |
|---|---|---|---|---|---|---|
| | Years Ended December 31, | | Years Ended December 31, | | Years Ended December 31, | |
| | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 |
| Revenues from unaffiliated customers | $ 40,415 | $ 32,414 | $ 7,442 | $ 9,030 | $ 47,857 | $ 41,444 |
| Cost of goods sold, inclusive of depreciation | (28,587) | (23,683) | (7,185) | (7,764) | (35,772) | $ (31,447) |
| Gross margin | 11,828 | 8,731 | 258 | 1,266 | 12,085 | 9,997 |
| Gross margin % | 29.3% | 26.9% | 3.5% | 14.0% | 25.3% | 24.1% |
| Selling, general and administrative | (5,423) | (5,992) | (2,320) | (1,853) | (7,743) | (7,845) |
| Interest | (73) | (45) | (34) | (32) | (107) | (77) |
| Total costs and expenses | (34,083) | (29,720) | (9,539) | (9,649) | (43,622) | (39,369) |
| Income (loss) before income tax provision | 6,332 | 2,694 | (2,097) | (619) | 4,235 | 2,075 |
| Income tax provision (benefits) | 1,102 | 984 | (365) | (226) | 737 | 758 |
| Net income/(loss) | $ 5,230 | $ 1,710 | $ (1,732) | $ (393) | $ 3,498 | $ 1,317 |
| Total assets | $ 31,647 | $ 26,331 | $ 10,038 | $ 11,655 | $ 41,685 | $ 37,986 |
| Capital expenditures | $ 1,689 | $ 1,998 | $ 177 | $ 178 | $ 1,866 | $ 2,176 |

# DIRECTORS

**Kenneth D. Trbovich**
Chairman of the Board of Directors and Chief Executive Officer, Servotronics, Inc.

**Edward C. Cosgrove, Esq.**
Attorney

**Lucion P. Gygax**
Major, Army National Guard

**Christopher M. Marks**
Financial Advisor

**Jason T. Bear**
Marketing Executive

# OFFICERS

**Kenneth D. Trbovich**
Chief Executive Officer and President

**Lisa F. Bencel**
Chief Financial Officer

**James C. Takacs**
Chief Operating Officer

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| **Registrar and Transfer Agent** | **General Counsel** | **Independent Auditors** |
|---|---|---|
| Computershare | Bond, Schoeneck & King, PLLC. | Freed Maxick CPAs, PC |
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| | Buffalo, NY 14202-2107 | |

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Form 10-K Report

Servotronics' Annual Report to the Securities and Exchange Commission on Form 10-K (including related financial statements and schedules) for its fiscal year ended December 31, 2018 is available to all stockholders, without charge, upon written request or visit our website at www.servotronics.com/investor-relations. Please address written requests to:

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