

SERVOTRONICS, INC.

2019 Form 10-K

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2019

or

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

Commission File No. 1-07109

SERVOTRONICS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

16-0837866

(I. R. S. Employer
Identification No.)

1110 Maple Street

Elma, New York 14059

(Address of principal executive offices) (zip code)

(716) 655-5990

(Registrant's telephone number, including area code)

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

Title of each class	Ticker symbol(s)	Name of each exchange on which registered
Common Stock	SVT	NYSE American

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

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 No

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 Securities Exchange Act.

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

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.

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

Yes No

Based on the closing price of the Common Stock on June 30, 2019 \$9.60 (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 \$15,269,041.

As of March 4, 2020, the number of \$.20 par value common shares outstanding was 2,477,099.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the 2020 Annual Meeting of Shareholders are incorporated by reference in Part III.

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PART I

Item 1. Business

General

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

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

The Company’s shares currently trade on the New York Stock Exchange (NYSE 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. We have a significant concentration of business with two major customers; Customer A and Customer B. Sales to Customer A accounted for 35.0% of consolidated sales in 2019 and 31.5% of consolidated sales in 2018. Sales to Customer B accounted for 19.8% of consolidated sales in 2019 and 17.4% of consolidated sales in 2018. In both 2019 and 2018 we had a concentration of sales to Customer A and Customer B representing approximately 54.8% and 48.9% of our consolidated sales, respectively. Two commercial aircraft accidents led to the grounding by the Federal Aviation Administration and other regulators of the Boeing 737 MAX aircraft. Approximately 27% of the 2019 units shipped to Customer A and approximately 13% of ATG total units shipped in 2019 support the Boeing 737 MAX aircraft production. It is expected that the shipments to Customer A for the Boeing 737 MAX will decrease by approximately 35% in 2020 as compared to the same period in 2019.

The loss of either of these customers or a significant reduction in business with them would significantly reduce our sales and earnings. 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. 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 2019 or 2018. 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 2019 and 2018 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 Franklinville, 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, 2019, had 375 employees of which 369 are full time and 29 full time contractors at two locations in New York. Approximately 90% of its employees and contractors 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:

<u>Location</u>	<u>Description</u>	<u>Principal product manufactured</u>	<u>Number of buildings and type of construction</u>	<u>Approx. floor area (sq. feet)</u>
Elma, New York	Corporate Headquarters and Manufacturing Facility	Advanced technology products	1-concrete block/steel	83,000
Franklinville, New York	Office and Manufacturing Facility	Advanced technology products 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 Stock exchange 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 4, 2020)
Common Stock, \$.20 par value per share	276

(c) Dividends on Common Stock

On May 15, 2019 the Company announced that its Board of Directors declared a \$0.16 per share cash dividend. The dividend was subsequently paid on July 15, 2019 to shareholders of record on June 28, 2019 and was approximately \$413,000 in the aggregate. These dividends do not represent that the Company will pay dividends on a regular or scheduled basis. The amount is recorded in dividends payable and as a reduction to retained earnings on the accompanying consolidated balance sheet.

(d) Company Purchases of Company's Equity Securities

2019 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	12,129 ⁽²⁾	\$10.51	2,400	92,577
April – June	2,102	10.22	2,102	90,475
July – September	730	10.24	730	89,745
October	2,000 ⁽²⁾	9.33	—	89,745
November	—	—	—	89,745
December	—	—	—	89,745
Total	16,961	\$10.32	5,232	89,745

- (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, 2019, the Company has purchased 360,255 shares and there remain 89,745 shares available to purchase under this program. There were 5,232 shares purchased by the Company in 2019.
- (2) Includes 9,729 shares withheld/purchased by the Company in January 2019 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.

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, 2019 and 2018, approximately 88% and 85%, respectively, of the Company's consolidated revenues were derived from the ATG sale of product to a small base of customers. During the years ended December 31, 2019 and 2018, approximately 12% and 15% of the Company's consolidated revenues were derived from the CPG sale of product to a large base of retail customers. There was an increase in 2019 from 2018 of approximately \$8,104,000 in shipments at the ATG and a decrease of approximately \$689,000 in shipments at the CPG.

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 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 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.

Outlook for 2020

In 2020, we will continue to execute our long-term strategy as we align and focus our resources to increase growth and profitability while addressing known and unknown factors in an ever-changing global environment.

Impact of COVID-19 Outbreak

Subsequent to year-end 2019, the World Health Organization declared the novel coronavirus (COVID-19) outbreak a public health emergency. There have been mandates from international, federal, state and local authorities requiring forced closures of various schools, businesses and other facilities and organizations. While the closures and limitations on movement, domestically and internationally, are expected to be temporary, if the outbreak continues on its current trajectory the duration of the supply chain disruption could reduce the availability, or result in delays, of materials or supplies to or from the Company, which in turn could materially interrupt the Company's business operations. Given the speed and frequency of continuously evolving developments with respect to this pandemic, the Company cannot reasonably estimate the magnitude of the impact to its results of operations.

Aircraft Liability Insurance

We are required to maintain certain levels of aircraft liability insurance pursuant to our long-term agreements with customers. In 2020, our aircraft liability insurance increased by approximately \$1,272,000. If we cannot offset this expense increase with cost savings or productivity improvements this could negatively impact our gross margin percent by approximately 2.5% based on 2019 revenues.

Results of Operations

The following table compares the Company's consolidated statements of income data for the years ended December 31, 2019 and 2018 (\$000's omitted).

	Twelve Months Ended December 31,				2019 vs 2018	
	2019		2018		Dollar Change	% Increase (Decrease)
	Dollars	% of Sales	Dollars	% of Sales		
Revenues:						
Advanced Technology	\$48,519	87.8%	\$40,415	84.4%	\$ 8,104	20.1%
Consumer Products	6,753	12.2%	7,442	15.6%	(689)	(9.3)%
	<u>55,272</u>	<u>100.0%</u>	<u>47,857</u>	<u>100.0%</u>	<u>7,415</u>	<u>15.5%</u>
Cost of goods sold, inclusive of depreciation and amortization	<u>43,146</u>	<u>78.1%</u>	<u>35,772</u>	<u>74.7%</u>	<u>7,374</u>	<u>20.6%</u>
Gross margin	<u>12,126</u>	<u>21.9%</u>	<u>12,085</u>	<u>25.3%</u>	<u>41</u>	<u>0.3%</u>
Gross margin %	21.9%		25.3%			
Selling, general and administrative	9,313	16.8%	7,743	16.2%	1,570	20.3%
Interest expense	125	0.2%	107	0.2%	18	16.8%
Total costs and expenses	<u>52,584</u>	<u>95.1%</u>	<u>43,622</u>	<u>91.2%</u>	<u>8,962</u>	<u>20.5%</u>
Income before income tax provision	2,688	4.9%	4,235	8.8%	(1,547)	(36.5)%
Income tax provision	579	1.0%	737	1.5%	(158)	(21.4)%
Net income	<u>\$ 2,109</u>	<u>3.8%</u>	<u>\$ 3,498</u>	<u>7.3%</u>	<u>\$(1,389)</u>	<u>(39.7)%</u>

Revenue

The Company's consolidated revenues from operations increased approximately \$7,415,000 or 15.5% for the twelve month period ended December 31, 2019 when compared to the same period in 2018. The increase in revenue is attributable to an increase in shipments at the ATG of approximately \$8,104,000 or 20.1% offset by a decrease in revenue at the CPG of approximately \$689,000 or (9.3)% for the twelve month period ended December 31, 2019 when compared to the same period in 2018.

The consolidate revenue increase for the twelve month period ended December 31, 2019 when compared to the same period in 2018 is attributed to the ATG with increased number units shipped of approximately \$4,657,000; ATG average price increase and mix of product sold of approximately \$3,447,000 and CPG average price increase and mix of product sold of approximately \$718,000 as compared to the same period ended December 31, 2018. This is offset by a decrease in revenue at the CPG due to a decrease in the number of units shipped of approximately \$1,407,000 as compared to the same period ended December 31, 2018.

Gross Margin

In 2019 gross margin as a percentage of revenues decreased at both the ATG and CPG compared to 2018. The 2.7% decrease in gross margin as a percentage of ATG revenue is primarily attributed to the write down of inventory, an increase in indirect labor, employee benefits, transportation and tooling, offset by overhead liquidation. The 14.8% decrease in gross margin as a percentage of CPG revenue is primarily attributed to a reduction in revenue and lower factory utilization at the Company's facility in Franklinville, NY. In terms of dollar value, the Company's consolidated gross margin increased slightly by approximately \$41,000 or 0.3% for the year ended December 31, 2019 when compared to the same period in 2018.

Gross margin improved in the twelve month period ended December 31, 2019 due to the increase in units shipped at the ATG of approximately \$1,494,000, at the ATG offset by a decrease in units shipped at the CPG of approximately \$129,000 and increased production costs per unit sold at both the ATG and CPG of approximately \$434,000 and \$890,000, respectively, when compared to the same period in 2018.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses as a percentage of revenues increased to 16.8% in 2019 compared to 16.2% in 2018. In terms of dollar value, SG&A increased approximately \$1,570,000 or 20.3% for the twelve month period ended December 31, 2019 compared to the same period in 2018. This is primarily driven by the increase of approximately \$1,165,000 at the ATG and by the increase of approximately \$405,000 at the CPG in 2019 compared to the same period in 2018. The increase in SG&A at the ATG is predominantly driven by an increase in headcount, wages and employee related benefits of approximately \$597,000; bad debt expense of approximately \$314,000; professional fees of approximately \$176,000 and Directors' fees of \$77,000 offset by a net increase of approximately \$1,000 in all other SG&A accounts in 2019 as compared to the same period in 2018. The increase in SG&A at the CPG is predominantly driven by an increase for the non-recurring costs of a business venture that was terminated of approximately \$237,000 and media advertising of approximately \$207,000 slightly offset by a net decrease of approximately \$39,000 in all other SG&A accounts in 2019 as compared to the same period in 2018.

Interest Expense

Interest expense increased approximately \$18,000 or 16.8% primarily due to the lease line of credit for equipment financing at the ATG for the twelve month period ended December 31, 2019 compared to the same period in 2018. See also Note 4, Long-Term Debt, of the accompanying consolidated financial statements for information on long-term debt.

Income Taxes

The Company's effective tax rate for operations was 21.5% in 2019 and 17.4% in 2018. The effective tax rate in both years reflects federal and state income taxes, permanent non-deductible expenditures, the deduction for foreign-derived intangible income (FDII), and the federal tax credit for research and development expenditures. The increase in the effective tax rate between 2018 and 2019 is a result of an increase in permanent non-deductible expenses and state taxes. See also Note 6, Income Taxes, of the accompanying consolidated financial statements for information concerning income taxes.

Net Income

Income from operations decreased approximately \$1,389,000 or 39.7% when comparing the twelve month period ended December 31, 2019 to the same period in 2018 as net income at the ATG was lower by approximately \$363,000 while the net loss at the CPG increased by approximately 1,026,000. This consolidated decrease is the result of decreases in gross margin percentage and increases in SG&A costs as 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, 2019, the Company had working capital of approximately \$27,659,000 (\$23,141,000 — 2018) of which approximately \$2,029,000 (\$2,598,000 — 2018) was comprised of cash.

The Company used approximately \$620,000 in cash from operations during the year ended December 31, 2019 as compared to generating approximately \$833,000 during the year ended December 31, 2018. Cash was generated primarily through net income of approximately \$2,109,000, adjustments to reconcile net income to net cash of approximately \$1,962,000 and timing of accounts payable. The primary use of cash for the Company's operating activities for the year ended December 31, 2019 include working capital requirements, mainly an increase in accounts receivables and inventories of approximately \$2,764,000 and \$4,895,000, respectively.

The Company's primary use of cash in its financing and investing activities in the year ended December 31, 2019 included approximately \$833,000 of current principal payments on long-term debt,

approximately \$409,000 for cash dividends as well as approximately \$157,000 for the purchase of treasury shares. The Company also expended approximately \$1,550,000, net of proceeds from equipment financing, for capital expenditures.

At December 31, 2019, the Company had a \$4,000,000 line of credit. As of March 20, 2020, the Company increased its line of credit to \$6,000,000. The line of credit expires on June 19, 2021. There was approximately \$3,000,000 balance outstanding at December 31, 2019.

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 \$468,000 outstanding at December 31, 2019 and approximately \$704,000 outstanding at December 31, 2018.

The Company had an equipment loan facility in the amount of \$2,500,000 available until November 30, 2019. This line was non-revolving and non-renewable. The loan term for the equipment covered by the agreement is 60 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 \$670,000 outstanding at December 31, 2019 and no balance 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, 2019. 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, 2019.

(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 2019 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 2019 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 MKT. 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 MKT.

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 2019 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, 2019:

<u>Plan category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights</u>	<u>Weighted-average exercise price of outstanding options warrants and rights</u>	<u>Number of securities remaining available for future issuance under equity compensation plans</u>
Equity compensation plans approved by security holders	—	—	93,302
Equity compensation plans not approved by security holders	—	—	—
Total	—	—	<u>93,302</u>

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 2019 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 2019 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 2019 fiscal year or such information will be included by amendment to this Form 10-K.

PART IV

Item 15. Exhibits and Financial Statement Schedules

- 3.1 Certificate of Incorporation of the Company (Incorporated by reference to Exhibit 3(A)(1) to the Company's Form 10-KSB for the year ended December 31, 1996)
- 3.2 Amendments to Certificate of Incorporation dated August 27, 1984 (Incorporated by reference to Exhibit 3(A)(2) to the Company's Form 10-KSB for the year ended December 31, 1996)
- 3.3 Amendments to Certificate of Incorporation dated June 30, 1998 (Incorporated by reference to Exhibit 3(A)(4) to the Company's Form 10-KSB for the year ended December 31, 1998)
- 3.4 Certificate of designation creating Series I preferred stock (Incorporated by reference to Exhibit 4(A) to the Company's Form 10-KSB for the year ended December 31, 1987)
- 3.5 By-laws of the Company (Incorporated by reference to Exhibit 3(B) to the Company's Form 10-KSB for the year ended December 31, 1986)
- 3.6 Amendment to By-laws dated January 2008 (Incorporated by reference to Exhibit 3.1 to Form 8-K filed with the SEC February 4, 2008)
- 4.1 Shareholder Rights Plan dated as of October 15, 2012 (Incorporated by reference to Exhibit 4.1 to the Company's Form 8-K filed with the SEC on October 17, 2012)
- 4.2 Amendment No. 1 to Shareholder Rights Plan dated as of March 11, 2015 (Incorporated by reference to Exhibit 4.1 to the Company's Form 8-K filed with the SEC on March 11, 2015)
- 10 Material Contracts (*Indicates management contract or compensatory plan or arrangement)
- 10.4* Employment Agreement for Kenneth D. Trbovich (Incorporated by reference to Exhibit 10.4 to the Company's Form 10-Q filed with the SEC on November 13, 2012)
- 10.5* Amendment to employment agreement for Kenneth D. Trbovich (Incorporated by reference to Exhibit 10.4 to the Company's Form 10-Q filed with the SEC on November 13, 2012)
- 10.6* Amendment to employment agreement for Kenneth D. Trbovich (Incorporated by reference to Exhibit 10.6 to the Company's Form 10-K filed with the SEC on March 20, 2015)
- 10.7 Form of Indemnification Agreement between the Registrant and each of its Directors and Officers (Incorporated by reference to Exhibit 10.7 for the year ended December 31, 2016)
- 10.8 Loan agreement between the Company and its employee stock ownership trust, as amended (Incorporated by reference to Exhibit 10(C)(1) to the Company's Form 10-KSB for the year ended December 31, 1991)
- 10.9 Stock purchase agreement between the Company and its employee stock ownership trust (Incorporated by reference to Exhibit 10(D)(2) to the Company's Form 10-KSB for the year ended December 31, 1988)
- 10.10* Servotronics, Inc. 2012 Long-Term Incentive Plan (Incorporated by reference to Appendix A to the Company's Proxy Statement for the 2012 Annual Meeting of Shareholders)
- 10.11 Loan Agreement dated as of December 1, 2014 between Servotronics, Inc. and Bank of America, N.A. (Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on December 4, 2014)

- 10.12 Loan Agreement dated as of December 1, 2014 between The Ontario Knife Company and Bank of America, N.A. (Incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed with the SEC on December 4, 2014)
- 10.13 Non-Employee Director Compensation Policy (Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on July 20, 2016)
 - 21 Subsidiaries of the Registrant (Filed herewith)
 - 23.1 Consent of Freed Maxick CPAs, P.C. (Filed herewith)
 - 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
 - 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith)
 - 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Furnished herewith)
 - 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Furnished herewith)
- 101 The following materials from Servotronics, Inc.'s Annual Report on Form 10-K for the period ended December 31, 2019, formatted in XBRL (eXtensible Business Reporting Language): (i) consolidated balance sheets, (ii) consolidated statements of income, (iii) consolidated statements of comprehensive income, (iv) consolidated statements of cash flows and (v) the notes to the consolidated financial statements.

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.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SERVOTRONICS, INC.

March 30, 2020

By /s/ Kenneth D. Trbovich
Kenneth D. Trbovich
Chief Executive Officer
and Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>/s/ Kenneth D. Trbovich</u> Kenneth D. Trbovich	Chief Executive Officer, Chairman of the Board and Director	March 30, 2020
<u>/s/ Lisa F. Bencel</u> Lisa F. Bencel	Chief Financial Officer	March 30, 2020
<u>/s/ Edward C. Cosgrove, Esq.</u> Edward C. Cosgrove, Esq.	Director	March 30, 2020
<u>/s/ Lucion P. Gygax</u> Lucion P. Gygax	Director	March 30, 2020
<u>/s/ Christopher M. Marks</u> Christopher M. Marks	Director	March 30, 2020
<u>/s/ Jason T. Bear</u> Jason T. Bear	Director	March 30, 2020

SERVOTRONICS, INC. AND SUBSIDIARIES
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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



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, 2019 and 2018, 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, 2019 and 2018, 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 30, 2020

SERVOTRONICS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(\$000's omitted except share and per share data)

	December 31, 2019	December 31, 2018
Current assets:		
Cash	\$ 2,029	\$ 2,598
Accounts receivable, net	13,183	10,586
Inventories, net	20,151	15,150
Prepaid income taxes	416	314
Other current assets	522	496
Total current assets	36,301	29,144
Property, plant and equipment, net	12,717	11,875
Deferred income taxes	107	295
Other non-current assets	345	371
Total Assets	\$49,470	\$41,685
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	\$ 548	\$ 548
Current portion of equipment financing and capital leases	301	175
Dividend payable	17	13
Accounts payable	4,458	2,494
Accrued employee compensation and benefits costs	2,283	1,908
Other accrued liabilities	1,035	865
Total current liabilities	8,642	6,003
Long-term debt	5,170	2,410
Post retirement obligation	2,126	1,759
Shareholders' equity:		
Common stock, par value \$0.20; authorized 4,000,000 shares; issued 2,614,506 shares; outstanding 2,399,576 (2,392,207 – 2018) shares	523	523
Capital in excess of par value	14,358	14,250
Retained earnings	20,484	18,788
Accumulated other comprehensive gain	98	35
Employee stock ownership trust commitment	(460)	(561)
Treasury stock, at cost 127,504 (117,979 – 2018) shares	(1,471)	(1,522)
Total shareholders' equity	33,532	31,513
Total Liabilities and Shareholders' Equity	\$49,470	\$41,685

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, 2019	December 31, 2018
Revenue	\$55,272	\$47,857
Costs and expenses:		
Costs of goods sold, inclusive of depreciation and amortization	43,146	35,772
Gross margin	12,126	12,085
Operating Expenses:		
Selling, general and administrative	9,313	7,743
Interest expense	125	107
Total operating expenses	9,438	7,850
Income before income tax provision	2,688	4,235
Income tax provision	579	737
Net income	\$ 2,109	\$ 3,498
Income per share:		
Basic		
Net income per share	\$ 0.91	\$ 1.54
Diluted		
Net income per share	\$ 0.88	\$ 1.49

See notes to consolidated financial statements

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

	Years Ended	
	December 31, 2019	December 31, 2018
Net Income	\$2,109	\$3,498
Other comprehensive income:		
Retirement benefits adjustment, net of income taxes	63	67
Total comprehensive income	\$2,172	\$3,565

See notes to consolidated financial statements

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

	Years Ended	
	December 31, 2019	December 31, 2018
Cash flows related to operating activities:		
Net Income	\$ 2,109	\$ 3,498
Adjustments to reconcile net income to net cash (used) generated by operating activities:		
Depreciation and amortization	1,268	1,025
Loss on disposal of property	137	1
Stock based compensation	316	276
Increase in allowance for doubtful accounts	167	21
(Decrease)/Increase in inventory reserve	(106)	105
(Decrease)/Increase in warranty reserve	(8)	389
Deferred income tax	188	114
Change in assets and liabilities:		
Accounts receivable	(2,764)	(2,183)
Inventories	(4,895)	(2,464)
Prepaid income taxes	(102)	(314)
Other current assets	(26)	(247)
Other non-current assets	49	—
Accounts payable	1,964	1,117
Accrued employee compensation and benefit costs	375	124
Other accrued liabilities	177	(399)
Accrued income taxes	—	(414)
Post retirement obligation	430	83
Employee stock ownership trust payment	101	101
Net cash (used) generated by operating activities	(620)	833
Cash flows related to investing activities:		
Capital expenditures – property, plant and equipment	(2,271)	(1,866)
Net cash used by investing activities	(2,271)	(1,866)
Cash flows related to financing activities:		
Principal payments on long-term debt	(548)	(548)
Principal payments on equipment financing lease obligations	(285)	(160)
Proceeds from equipment note and equipment financing lease	721	210
Proceeds from line of credit	3,000	—
Purchase of treasury shares	(157)	(175)
Cash dividend	(409)	(403)
Net cash provided (used) by financing activities	2,322	(1,076)
Net decrease in cash	(569)	(2,109)
Cash at beginning of year	2,598	4,707
Cash at end of year	\$ 2,029	\$ 2,598
Supplemental Cash Flow Information:		
Equipment acquired through financing paid directly to vendor	\$ 333	\$ —

See notes to consolidated financial statements

SERVOTRONICS, INC. AND SUBSIDIARIES
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

The Company considers cash 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 \$337,000 at December 31, 2019 and \$170,000 at December 31, 2018. The Company does not accrue interest on past due receivables.

Note Receivable

There was a note receivable with a balance of \$125,000 as of September 30, 2019 and recorded as other current assets in the accompanying balance sheet. The note was with a third party with the intent to develop a business venture. As of October 21, 2019, the note receivable plus an additional \$18,000 was converted to capitalized tooling and owned by the CPG. The total capitalized tooling is approximately \$143,000.

As of December 9, 2019 the business venture was terminated. The capitalized tooling, computer equipment, a 3D printer, final payments and interest owed the CPG were expensed. The approximate costs of the dissolution of \$237,000 is included in CPG's Selling, general & administrative expenses.

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

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

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, 2019 and December 31, 2018 under the guidance of ASC460 the Company has recorded a warranty reserve of approximately \$420,000 and \$428,000, 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 year are applied to the gross value of the inventory through a reserve of approximately \$1,437,000 and \$1,543,000 at December 31, 2019 and December 31, 2018, 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 years 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.

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 various separate state income tax returns.

The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company did not have any accrued interest or penalties included in its consolidated balance sheets at December 31, 2019 or December 31, 2018, and did not recognize any interest and/or penalties in its consolidated statements of income during the years ended December 31, 2019 and 2018. The Company did not have any material uncertain tax positions or unrecognized tax benefits or obligations as of December 31, 2019 and December 31, 2018. The 2016 through 2018 federal and state tax returns remain subject to examination.

Supplemental Cash Flow Information

Income taxes paid during the twelve month periods ended December 31, 2019 and 2018 amounted to approximately \$524,000 and \$1,325,000, respectively. Interest paid during the twelve month periods ended December 31, 2019 and 2018 amounted to approximately \$125,000 and \$107,000, 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, 2019 and December 31, 2018.

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.

SERVOTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

The Company had sales of advanced technology products to two customers, including various divisions and subsidiaries of a common parent company, which represented more than 10% of consolidated revenues in 2019. Total revenues from these two customers amounted to approximately 55% in 2019 as compared to the same two customers amounting to approximately 49% of the Company's consolidated revenues in 2018. 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

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." The new standard requires a lessee to record on the balance sheet the assets and liabilities for the rights and obligations created by leases with lease terms of more than 12 months and requires both lessees and lessors to disclose certain key information about lease transactions. The standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company adopted this standard during the first quarter of 2019. The adoption of this guidance did not have a material impact on the Company's financial statements and related disclosures. The Company originally financed four pieces of equipment through a lease line of credit and have recognized a lease liability and a ROU (Right of Use) asset for each piece of equipment. During 2019 one piece of equipment was traded and financed through our equipment note obligations leaving three remaining ROU assets. Finance lease assets are included in property, plant, and equipment, and liabilities are included in short-term and long-term debt.

2. Inventories

	December 31, 2019	December 31, 2018
	(\$000's omitted)	
Raw material and common parts	\$14,707	\$ 9,088
Work-in-process	4,158	5,123
Finished goods	2,723	2,482
	21,588	16,693
Less inventory reserve	(1,437)	(1,543)
Total inventories	\$20,151	\$15,150

SERVOTRONICS, INC. AND SUBSIDIARIES
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3. Property, Plant and Equipment

	December 31, 2019	December 31, 2018
	(\$000's omitted)	
Land	\$ 7	\$ 7
Buildings	11,017	10,452
Machinery, equipment and tooling	20,695	18,345
Construction in progress	331	1,258
	32,050	30,062
Less accumulated depreciation and amortization	(19,333)	(18,187)
Property, plant and equipment, net	\$ 12,717	\$ 11,875

Depreciation and amortization expense amounted to approximately \$1,268,000 and \$1,025,000 for the year ended December 31, 2019 and 2018, respectively. Depreciation expense amounted to approximately \$1,178,000 and \$948,000 for the year ended December 31, 2019 and 2018, respectively. Amortization expense primarily related to capital leases amounted to approximately \$90,000 and \$77,000 for the year ended December 31, 2019 and 2018, 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.

The Company's ROU assets included in machinery, equipment and tooling had a net book value of approximately \$728,000 (\$811,000 — 2018).

As of December 31, 2019, there is approximately \$331,000 (\$1,258,000 — 2018) of construction in progress (CIP) included in property, plant and equipment all of which is related to capital projects. There is approximately \$280,000 in CIP for the machinery and equipment and self-constructed assets, \$32,000 of computer equipment and \$19,000 for building improvements primarily at the Advance Technology Group.

SERVOTRONICS, INC. AND SUBSIDIARIES
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4. Long-Term Debt

	December 31, 2019	December 31, 2018
	(\$000's omitted)	
Line of credit payable to a financial institution; Interest rate option of bank prime or Libor plus 1.4% (3.1085% as of December 31, 2019) ^(A)	\$3,000	\$ —
Term loan payable to a financial institution; Interest rate option of bank prime or Libor plus 1.4% (3.1085% as of December 31, 2019), monthly principal payments of \$21,833 through 2021 with a balloon payment of \$786,000 due December 1, 2021 ^(B)	1,310	1,572
Term loan payable to a financial institution; Interest rate option of bank prime or Libor plus 1.4% (3.1085% as of December 31, 2019), monthly principal payments of \$23,810 through December 1, 2021 ^(B)	571	857
Equipment note obligations; Interest rate fixed for term of each funding based upon the Lender's lease pricing at time of funding. (Interest rate/factor 3.3943% – 3.8527% at time of funding) ^(C)	670	0
Equipment financing lease obligations; Interest rate fixed for term 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) ^(D)	468	704
	6,019	3,133
Less current portion	(849)	(723)
	\$5,170	\$2,410

- (A) At December 31, 2019, the Company had a \$4,000,000 line of credit. As of March 20, 2020, the Company increased its line of credit to \$6,000,000. The interest rate is a rate per year equal to the bank's prime rate or Libor plus 1.4%. In addition, effective June 17, 2019, the Company is required to pay a commitment fee of 0.15% on the unused portion of the line of credit. The line of credit expires June 19, 2021. There was \$3,000,000 balance outstanding at December 31, 2019 and \$0 balance at December 31, 2018.
- (B) 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, 2019 and December 31, 2018 the Company was in compliance with these covenants.
- (C) The Company had an equipment loan facility in the amount of \$2,500,000 available until November 30, 2019. This line was non-revolving and non-renewable. The loan term for the equipment covered by the agreement is 60 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 \$670,000 outstanding at December 31, 2019 and no balance outstanding at December 31, 2018.
- (D) The Company established a lease line of credit for equipment financing in the amount of \$1,000,000 available until June 28, 2018. This line was non-revolving and non-renewable. The lease term for equipment covered by the lease line of credit is 60 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 \$468,000 outstanding at December 31, 2019 and \$704,000 at December 31, 2018.

SERVOTRONICS, INC. AND SUBSIDIARIES
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Principal maturities of long-term debt are as follows: 2020 — \$849,000, 2021 — \$4,635,000, 2022 — \$288,000, 2023 — \$154,000, and 2023 — \$93,000. Remaining principal payments for the capital note and capital lease obligations for each of the next five years:

Year	December 31, 2019
	(\$000's omitted)
2020	331
2021	331
2022	316
2023	169
2024	97
Total principal and interest payments	1,244
Less amount representing interest	(106)
Present value of net minimum lease payments	1,138
Less current portion	(301)
Long term principle payments	<u>\$ 837</u>

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 MKT, formerly known as the American Stock Exchange. There were no outstanding shares subject to the repurchase obligation at December 31, 2019.

Since inception of the ESOP, 414,515 shares have been allocated, exclusive of shares distributed to ESOP participants. At December 31, 2019 and 2018, 87,425 and 104,320 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 2019 and 2018. Included as a reduction to shareholders' equity is the ESOP trust commitment which represents the

SERVOTRONICS, INC. AND SUBSIDIARIES
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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 and President, Kenneth Trbovich. 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, 2019 and 2018 is approximately \$583,000 and \$644,000, 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, 2019 under the Plan. Estimated future annual expenses associated with the plan are immaterial. Included in accumulated other comprehensive income for 2019 and 2018 is approximately \$63,000 and \$67,000, respectively, net of deferred taxes, associated with the unrecognized service cost of the plan.

6. Income Taxes

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

	December 31, 2019	December 31, 2018
	(\$000's omitted)	
Current:		
Federal	\$363	\$639
State	45	2
	408	641
Deferred:		
Federal	171	96
	171	96
	\$579	\$737

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:

	December 31, 2019	December 31, 2018
Federal statutory rate	21.0%	21.0%
Permanent non-deductible expenses	2.6%	0.3%
Business credits	-3.0%	-0.6%
ESOP dividend	-0.6%	-0.4%
Stock compensation	-0.1%	-0.4%
Domestic production activities deduction	0.0%	-0.4%
Foreign-derived intangible income deduction	-1.2%	-1.8%
State taxes, net of federal benefit	1.3%	0.0%
Other	1.5%	-0.3%
	21.5%	17.4%

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At December 31, 2019 and 2018, the deferred tax assets (liabilities) were comprised of the following:

	December 31, 2019	December 31, 2018
	(\$000's omitted)	
Deferred tax assets:		
Inventories	\$ 473	\$ 417
Accrued employees compensation and benefits costs	446	478
Accrued arbitration award and related liability	324	234
Net operating loss and credit carryforwards	236	248
Bad debt reserve	71	37
Warranty reserve	88	90
Total deferred tax assets	1,638	1,504
Valuation allowance	(236)	(248)
Net deferred tax assets	1,402	1,256
Deferred tax liabilities:		
Prepaid expenses	(32)	(28)
Property, plant and equipment	(1,238)	(910)
Other	—	(14)
Minimum pension liability	(25)	(9)
Total deferred tax liabilities	(1,295)	(961)
Net deferred tax assets	\$ 107	\$ 295

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, 2019, except for a valuation allowance of \$236,000 (\$248,000 — 2018) related to certain state net operating loss carryforwards, state tax credit carryforwards and other state net deferred tax assets. At December 31, 2019, the Company has net operating loss carryforwards with full valuation allowances from Pennsylvania of approximately \$1,620,000 (\$1,805,000 — 2018), which begin expiring in 2020, and Arkansas of approximately \$0 (\$31,000 — 2018). The Company also has a New York state tax credit carryforward at December 31, 2019 of approximately \$139,000 (\$131,000 — 2018), which begins to expire in 2023.

There are no uncertain tax positions or unrecognized tax benefits for 2019 and 2018. The Company is subject to routine audits of its tax returns by the Internal Revenue Service and various state taxing authorities. The 2016 through 2018 Federal and state tax returns remain subject to examination.

SERVOTRONICS, INC. AND SUBSIDIARIES
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7. Shareholders' Equity

	Twelve-month Period Ended December 31, 2019						
	Retained Earnings	Accumulated Other Comprehensive Income	Common Stock	Capital in excess of par value	ESOT	Treasury stock	Total shareholders' equity
January 1, 2019	\$18,788	\$35	\$523	\$14,250	\$(561)	\$(1,522)	\$31,513
Purchase of treasury shares	—	—	—	—	—	(128)	(128)
Stock based compensation	—	—	—	14	—	44	58
Net Income	98	—	—	—	—	—	98
March 31, 2019	<u>\$18,886</u>	<u>\$35</u>	<u>\$523</u>	<u>\$14,264</u>	<u>\$(561)</u>	<u>\$(1,606)</u>	<u>\$31,541</u>
Dividends declared (\$0.16 per share)	(413)	—	—	—	—	—	(413)
Purchase of treasury shares	—	—	—	—	—	(21)	(21)
Stock based compensation	—	—	—	34	—	61	95
Net Income	714	—	—	—	—	—	714
June 30, 2019	<u>\$19,187</u>	<u>\$35</u>	<u>\$523</u>	<u>\$14,298</u>	<u>\$(561)</u>	<u>\$(1,566)</u>	<u>\$31,916</u>
Purchase of treasury shares	—	—	—	—	—	(8)	(8)
Stock based compensation	—	—	—	28	—	58	86
Net Income	1,132	—	—	—	—	—	1,132
September 30, 2019	<u>\$20,319</u>	<u>\$35</u>	<u>\$523</u>	<u>\$14,326</u>	<u>\$(561)</u>	<u>\$(1,516)</u>	<u>\$33,126</u>
Retirement benefits adjustment . .	—	63	—	—	101	—	164
Stock based compensation	—	—	—	32	—	45	77
Net Income	165	—	—	—	—	—	165
December 31, 2019	<u>\$20,484</u>	<u>\$98</u>	<u>\$523</u>	<u>\$14,358</u>	<u>\$(460)</u>	<u>\$(1,471)</u>	<u>\$33,532</u>

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Twelve-month Period Ended December 31, 2018

	Retained Earnings	Accumulated Other Comprehensive Income	Common Stock	Capital in excess of par value	ESOT	Treasury stock	Total shareholders' equity
January 1, 2018	\$15,709	\$(32)	\$523	\$14,171	\$(662)	\$(1,544)	\$28,165
Purchase of treasury shares	—	—	—	—	—	(117)	(117)
Net Income	331	—	—	—	—	—	331
March 31, 2018	<u>\$16,040</u>	<u>\$(32)</u>	<u>\$523</u>	<u>\$14,171</u>	<u>\$(662)</u>	<u>\$(1,661)</u>	<u>\$28,379</u>
Dividends declared (\$0.16 per share)	(416)	—	—	—	—	—	(416)
Purchase of treasury shares	—	—	—	—	—	(33)	(33)
Stock based compensation	(6)	6	—	21	—	64	85
Net Income	707	—	—	—	—	—	707
June 30, 2018	<u>\$16,325</u>	<u>\$(26)</u>	<u>\$523</u>	<u>\$14,192</u>	<u>\$(662)</u>	<u>\$(1,630)</u>	<u>\$28,722</u>
Dividends declared (\$0.16 per share)	3	—	—	—	—	—	3
Stock based compensation	—	—	—	34	—	64	98
Net Income	1,457	—	—	—	—	—	1,457
September 30, 2018	<u>\$17,785</u>	<u>\$(26)</u>	<u>\$523</u>	<u>\$14,226</u>	<u>\$(662)</u>	<u>\$(1,566)</u>	<u>\$30,280</u>
Compensation Expense	—	—	—	—	101	—	101
Retirement benefits adjustment	—	67	—	—	—	—	67
Purchase of treasury shares	—	—	—	—	—	(25)	(25)
Stock based compensation	—	(6)	—	24	—	69	87
Net Income	1,003	—	—	—	—	—	1,003
December 31, 2018	<u>\$18,788</u>	<u>\$ 35</u>	<u>\$523</u>	<u>\$14,250</u>	<u>\$(561)</u>	<u>\$(1,522)</u>	<u>\$31,513</u>

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, 2019, the Company has purchased 360,255 shares and there remain 89,745 shares available to purchase under this program. There were 5,232 shares purchased by the Company in 2019.

On January 1, 2019, 26,250 shares of restricted stock vested of which 9,729 shares were withheld by the Company for approximately \$99,000 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.

The Company's director compensation policy provides that 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. These shares vest quarterly over a twelve month service period, have voting rights and accrue dividends that are paid upon vesting. The aggregate amount of expense to the Company, measured based on the

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grant date fair value, will be recognized over the requisite service period. An aggregate of 4,288 restricted shares were issued on May 25, 2018 with a grant date fair value of \$40,000. An aggregate of 7,836 restricted shares were issued on April 26, 2019 with a grant date fair value of \$100,000.

Included in the year ended December 31, 2019 and 2018 is approximately \$316,000 and \$276,000, respectively, of stock-based compensation expense related to the restrictive share awards. We have approximately \$286,000 in unvested shares to be recognized in 2020.

On May 15, 2019 the Company announced that its Board of Directors declared a \$0.16 per share cash dividend. The dividend was subsequently paid on July 15, 2019 to shareholders of record on June 28, 2019 and was approximately \$413,000 in the aggregate. These dividends do not represent that the Company will pay dividends on a regular or scheduled basis. The amount is 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, 2019	December 31, 2018
	(\$000's omitted except for per share data)	
Net Income	\$2,109	\$3,498
Weighted average common shares outstanding (basic)	2,330	2,272
Unvested restricted stock	56	81
Weighted average common shares outstanding (diluted)	2,386	2,353
<u>Basic</u>		
Net income per share	\$ 0.91	\$ 1.54
<u>Diluted</u>		
Net income per share	\$ 0.88	\$ 1.49

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, 2019, there is no unrecognized compensation related to the unvested restricted shares vested on January 1, 2020.

SERVOTRONICS, INC. AND SUBSIDIARIES
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A summary of the status of restricted share awards granted under all employee plans is presented below:

	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Restricted Share Activity:		
Unvested at December 31, 2017	28,500	\$ 7.96
Granted in 2018	83,038	9.33
Vested in 2018	30,644	\$ 8.06
Unvested at December 31, 2018	80,894	\$ 9.33
Granted in 2019	7,836	\$12.77
Forfeited in 2019	2,000	\$ 9.33
Vested in 2019	32,314	\$ 9.75
Unvested at December 31, 2019	54,416	\$ 9.58

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 \$1,543,000 and \$1,115,000 has been accrued as of December 31, 2019 and December 31, 2018, and is reflected as Post Retirement Obligation in the accompanying balance sheet.

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 \$583,000 and \$644,000 has been accrued as of December 31, 2019 and December 31, 2018, respectively, and is reflected as Post Retirement Obligation in the accompanying balance sheet.

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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 has not considered the risk of loss to be probable, and is unable to reasonably or accurately estimate the likelihood and amount of any liability or benefit that may be realized as a result of this litigation. Accordingly, no gain or loss has been recognized in the accompanying financial 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 \$197,000 and \$141,000 in the year ended December 31, 2019 and 2018, 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, 2019 and 2018 of approximately \$52,000 and \$19,000, 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.

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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,	
	2019	2018	2019	2018	2019	2018
Revenues from unaffiliated customers . . .	\$ 48,519	\$ 40,415	\$ 6,753	\$ 7,442	\$ 55,272	\$ 47,857
Cost of goods sold, inclusive of depreciation	(35,632)	(28,587)	(7,514)	(7,185)	(43,146)	\$(35,772)
Gross margin	12,887	11,828	(761)	258	12,126	12,085
Gross margin %	26.6%	29.3%	-11.3%	3.5%	21.9%	25.3%
Selling, general and administrative . . .	(6,588)	(5,423)	(2,725)	(2,320)	(9,313)	(7,743)
Interest	(97)	(73)	(28)	(34)	(125)	(107)
Total costs and expenses	(42,317)	(34,083)	(10,268)	(9,539)	(52,584)	(43,622)
Income (loss) before income tax provision	6,203	6,332	(3,515)	(2,097)	2,688	4,235
Income tax provision (benefits)	1,336	1,102	(757)	(365)	579	737
Net income/(loss)	\$ 4,867	\$ 5,230	\$ (2,758)	\$ (1,732)	\$ 2,109	\$ 3,498
Total assets	\$ 39,989	\$ 31,647	\$ 9,481	\$10,038	\$ 49,470	\$ 41,685
Capital expenditures	\$ 1,990	\$ 1,689	\$ 281	\$ 177	\$ 2,271	\$ 1,866

12. Subsequent Events

As previously disclosed subsequent to year-end 2019, the World Health Organization declared the novel coronavirus (COVID-19) outbreak a public health emergency. There have been mandates from international, federal, state and local authorities requiring forced closures of various schools, businesses and other facilities and organizations. While the closures and limitations on movement, domestically and internationally, are expected to be temporary, if the outbreak continues on its current trajectory the duration of the supply chain disruption could reduce the availability, or result in delays, of materials or supplies to or from the Company, which in turn could materially interrupt the Company's business operations. Given the speed and frequency of continuously evolving developments with respect to this pandemic, the Company cannot reasonably estimate the magnitude of the impact to its results of operations.

The Company's operations are continuing in compliance with the New York Governor's Executive Orders (202.6 202.7 202.8 and the guidance provided by New York State's Department of Economic Development) regarding "Essential Business" in New York and Homeland Security Presidential Directive 21 which classifies certain assets and infrastructure as "critical infrastructure." As such all personnel deemed essential will continue to report to work and the Company has implemented and will continue to monitor safeguards designed to promote social distancing and a safe working environment.

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SERVOTRONICS, INC.
SUBSIDIARIES OF
REGISTRANT

<u>Name and address of each member</u>	<u>Employer ID No.</u>
Servotronics, Inc. P.O. Box 300 Elma, New York 14059-0300	16-0837866
Ontario Knife Company 26 Empire Street Franklinville, New York 14737	16-0578540
Queen Cutlery Company 507 Chestnut Street Titusville, Pennsylvania 16354	25-0743840
G.N. Metal Products, Inc. P.O. Box 300 Elma, New York 14059-0300	16-0964682
SVT Management, Inc. P.O. Box 300 Elma, New York 14059-0300	16-1037766
MRO Corporation P.O. Box 300 Elma, New York 14059-0300	16-1230799
TSV ELMA, Inc. P.O. Box 300 Elma, New York 14059-0300	16-1415699
87 South Main Corp. P.O. Box 300 Elma, New York 14059-0300	20-2776383
King Cutlery, Inc. P.O. Box 300 Elma, New York 14059-0300	33-1112061
TSV Franklinville, Inc. P.O. Box 300 Elma, New York 14059-0300	52-2364297
Aero Metal Products P.O. Box 300 Elma, New York 14059-0300	27-1143686



CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (No. 333-187433 and No. 333-104464) on Form S-8 of Servotronics, Inc. and Subsidiaries of our report dated March 30, 2020, relating to our audits of the consolidated financial statements, which appear in the Annual Report on Form 10-K of Servotronics, Inc. and Subsidiaries as of and for the years ended December 31, 2019 and 2018.

Freed Maxick CPAs, P.C.

Buffalo, New York
March 30, 2020

CERTIFICATION

I, Kenneth D. Trbovich, certify that:

1. I have reviewed this annual report on Form 10-K of Servotronics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 30, 2020

/s/ Kenneth D. Trbovich

Kenneth D. Trbovich
Chief Executive Officer

CERTIFICATION

I, Lisa F. Bencel, certify that:

1. I have reviewed this annual report on Form 10-K of Servotronics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 30, 2020

/s/ Lisa F. Bencel

Lisa F. Bencel
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of Servotronics, Inc. (the “Company”), on Form 10-K for the period ended December 31, 2019, I hereby certify solely for the purpose of complying with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1. The annual report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Act of 1934, and
2. The information contained in the annual report fairly represents, in all materials respects, the financial condition and results of operations of the Company.

Date: March 30, 2020

/s/ Kenneth D. Trbovich

Kenneth D. Trbovich
Chief Executive Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of Servotronics, Inc. (the “Company”), on Form 10-K for the period ended December 31, 2019, I hereby certify solely for the purpose of complying with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1. The annual report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Act of 1934, and
2. The information contained in the annual report fairly represents, in all materials respects, the financial condition and results of operations of the Company.

Date: March 30, 2020

/s/ Lisa F. Bencel

Lisa F. Bencel
Chief Financial Officer

DIRECTORS

Kenneth D. Trbovich

Chairman of the Board of Directors

President and Chief Executive Officer, Servotronics, Inc.

Edward C. Cosgrove, Esq.

Attorney, The Cosgrove Firm

Lucion P. Gygax

Lieutenant Colonel, Army National Guard

Christopher M. Marks

Partner, Jensen, Marks, Langer & Vance LLC, an independent financial planning firm

Jason T. Bear

President, Full Throttle Communications, Inc., a marketing and public relations firm

OFFICERS

Kenneth D. Trbovich

Chief Executive Officer and President

Lisa F. Bencel

Chief Financial Officer

James C. Takacs

Chief Operating Officer

Bernadine E. Kucinski

Corporate Secretary

Michael F. McKee

Vice President

Registrar and Transfer Agent

Computershare
250 Royall Street
Canton, MA 02021-1011

General Counsel

Bond, Schoeneck & King, PLLC.
Avant Building - Suite 900
200 Delaware Avenue
Buffalo, NY 14202-2107

Independent Auditors

Freed Maxick CPAs, PC
424 Main Street - Suite 800
Buffalo, NY 14202-3508

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, 2019 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:

Bernadine E. Kucinski
Corporate Secretary
Servotronics, Inc.
1110 Maple Road
P.O. Box 300
Elma, NY 14059-0300

