

SYPRIS SOLUTIONS INC  
Form 10-Q  
August 06, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington D.C. 20549**

**FORM 10-Q**

(Mark One)

Quarterly Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934  
For the quarterly period ended June 30, 2013

OR

Transition Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission file number: 0-24020**

**SYPRIS SOLUTIONS, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

**61-1321992**

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(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

**101 Bullitt Lane, Suite 450** (502) 329-2000  
**Louisville, Kentucky 40222** (Registrant's telephone number,  
(Address of principal executive offices) (Zip code) including area code)

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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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such reports). Yes No

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

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

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

As of July 26, 2013 the Registrant had 20,383,055 shares of common stock outstanding.

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

|         |   |    |
|---------|---|----|
| ITEM 1. | FINANCIAL STATEMENTS  |    |
|         | Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2013 and July 1, 2012           | 2  |
|         | Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2013 and July 1, 2012 | 3  |
|         | Consolidated Balance Sheets at June 30, 2013 and December 31, 2012  | 4  |
|         | Consolidated Cash Flow Statements for the Six Months Ended June 30, 2013 and July 1, 2012                         | 5  |
|         | Notes to Consolidated Financial Statements  | 6  |
| ITEM 2. | MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS                             | 13 |
| ITEM 3. | QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK  | 20 |
| ITEM 4. | CONTROLS AND PROCEDURES   | 20 |

**PART II. OTHER INFORMATION**

|            |   |    |
|------------|---|----|
| ITEM 1.    | LEGAL PROCEEDINGS   | 21 |
| ITEM 1A.   | RISK FACTORS  | 21 |
| ITEM 2.    | UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS | 21 |
| ITEM 3.    | DEFAULTS UPON SENIOR SECURITIES                             | 21 |
| ITEM 4.    | MINE SAFETY DISCLOSURES                                     | 21 |
| ITEM 5.    | OTHER INFORMATION   | 22 |
| ITEM 6.    | EXHIBITS  | 22 |
| SIGNATURES |   | 23 |

**Part I. Financial Information****Item 1. Financial Statements****Sypris Solutions, Inc.****Consolidated Statements of Operations****(in thousands, except for per share data)**

|  | <b>Three Months Ended</b> |                | <b>Six Months Ended</b> |                |
|--|---------------------------|----------------|-------------------------|----------------|
|  | <b>June 30,</b>           | <b>July 1,</b> | <b>June 30,</b>         | <b>July 1,</b> |
|  | <b>2013</b>               | <b>2012</b>    | <b>2013</b>             | <b>2012</b>    |
|  | <b>(Unaudited)</b>        |                | <b>(Unaudited)</b>      |                |
| Net revenue:   |                           |                |                         |                |
| Outsourced services                                    | \$74,373                  | \$85,252       | \$146,456               | \$166,534      |
| Products   | 7,793                     | 13,660         | 14,121                  | 28,841         |
| Total net revenue                                      | 82,166                    | 98,912         | 160,577                 | 195,375        |
| Cost of sales:   |                           |                |                         |                |
| Outsourced services                                    | 67,380                    | 75,728         | 132,590                 | 147,742        |
| Products   | 6,450                     | 9,961          | 11,575                  | 21,896         |
| Total cost of sales                                    | 73,830                    | 85,689         | 144,165                 | 169,638        |
| Gross profit   | 8,336                     | 13,223         | 16,412                  | 25,737         |
| Selling, general and administrative                    | 7,598                     | 7,698          | 14,756                  | 15,293         |
| Research and development                               | 1,419                     | 1,035          | 2,296                   | 1,429          |
| Amortization of intangible assets                      | 8                         | 22             | 30                      | 44             |
| Impairment of goodwill                                 | 0                         | 0              | 6,900                   | 0              |
| Operating (loss) income                                | (689 )                    | 4,468          | (7,570 )                | 8,971          |
| Interest expense, net                                  | 120                       | 105            | 266                     | 222            |
| (Gain) on sale of marketable securities                | 0                         | (537 )         | 0                       | (537 )         |
| Other (income), net                                    | (259 )                    | (457 )         | (1,454 )                | (2,531 )       |
| (Loss) income from continuing operations, before taxes | (550 )                    | 5,357          | (6,382 )                | 11,817         |
| Income tax expense                                     | 944                       | 343            | 1,571                   | 1,292          |
| (Loss) income from continuing operations               | (1,494 )                  | 5,014          | (7,953 )                | 10,525         |
| Loss from discontinued operations, net of tax          | 0                         | (576 )         | 0                       | (799 )         |
| Net (loss) income                                      | \$(1,494 )                | \$4,438        | \$(7,953 )              | \$9,726        |
| Basic (loss) income per share:                         |                           |                |                         |                |
| (Loss) income per share from continuing operations     | \$(0.08 )                 | \$0.25         | \$(0.41 )               | \$0.53         |
| Loss per share from discontinued operations            | 0.00                      | (0.03 )        | 0.00                    | (0.04 )        |

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|  |            |         |            |         |
|--|------------|---------|------------|---------|
| Net (loss) income per share                        | \$ (0.08 ) | \$ 0.22 | \$ (0.41 ) | \$ 0.49 |
| Diluted (loss) income per share:                   |            |         |            |         |
| (Loss) income per share from continuing operations | \$ (0.08 ) | \$ 0.25 | \$ (0.41 ) | \$ 0.52 |
| Loss per share from discontinued operations        | 0.00       | (0.03 ) | 0.00       | (0.04 ) |
| Net (loss) income per share                        | \$ (0.08 ) | \$ 0.22 | \$ (0.41 ) | \$ 0.48 |
| Weighted average shares outstanding:               |            |         |            |         |
| Basic  | 19,347     | 19,068  | 19,255     | 19,020  |
| Diluted  | 19,347     | 19,433  | 19,255     | 19,361  |
| Dividends declared per common share                | \$ 0.02    | \$ 0.02 | \$ 0.04    | \$ 0.04 |

The accompanying notes are an integral part of the consolidated financial statements.

**Sypris Solutions, Inc.****Consolidated Statements of Comprehensive Income****(in thousands)**

|  | <b>Three Months<br/>Ended</b> |                | <b>Six Months<br/>Ended</b> |                |
|--|-------------------------------|----------------|-----------------------------|----------------|
|  | <b>June<br/>30,</b>           | <b>July 1,</b> | <b>June<br/>30,</b>         | <b>July 1,</b> |
|  | <b>2013</b>                   | <b>2012</b>    | <b>2013</b>                 | <b>2012</b>    |
|  | <b>(Unaudited)</b>            |                | <b>(Unaudited)</b>          |                |
| Net (loss) income  | \$ (1,494)                    | \$ 4,438       | \$ (7,953)                  | \$ 9,726       |
| Other comprehensive (loss) income:   |                               |                |                             |                |
| Foreign currency translation adjustments   | (1,264)                       | (1,690)        | 452                         | 647            |
| Reclassification adjustment for net gain on marketable securities included in net income | 0                             | (662 )         | 0                           | (515 )         |
| Unrealized (loss) gain on marketable securities  | 0                             | (269 )         | 0                           | 66             |
| Other comprehensive (loss) income, net of tax  | (1,264)                       | (2,621)        | 452                         | 198            |
| Total comprehensive (loss) income  | \$ (2,758)                    | \$ 1,817       | \$ (7,501)                  | \$ 9,924       |

The accompanying notes are an integral part of the consolidated financial statements.

**Sypris Solutions, Inc.****Consolidated Balance Sheets****(in thousands, except for share data)**

|   | <b>June 30,</b>    | <b>December</b> |
|---|--------------------|-----------------|
|   | <b>2013</b>        | <b>31,</b>      |
|   | <b>2012</b>        |                 |
|   | <b>(Unaudited)</b> |                 |
| <b>Assets</b>   |                    |                 |
| Current assets:   |                    |                 |
| Cash and cash equivalents   | \$ 18,391          | \$ 18,664       |
| Accounts receivable, net  | 52,909             | 38,530          |
| Inventory, net  | 38,160             | 33,958          |
| Other current assets  | 4,087              | 4,946           |
| Total current assets  | 113,547            | 96,098          |
| Property, plant and equipment, net  | 47,675             | 53,050          |
| Goodwill  | 0                  | 6,900           |
| Other assets  | 4,501              | 4,920           |
| Total assets  | \$ 165,723         | \$ 160,968      |
| <b>Liabilities and Stockholders' Equity</b>   |                    |                 |
| Current liabilities:  |                    |                 |
| Accounts payable  | \$ 52,077          | \$ 36,267       |
| Accrued liabilities   | 22,491             | 21,988          |
| Total current liabilities   | 74,568             | 58,255          |
| Long-term debt  | 20,000             | 19,000          |
| Other liabilities   | 16,078             | 20,780          |
| Total liabilities   | 110,646            | 98,035          |
| Stockholders' equity:   |                    |                 |
| Preferred stock, par value \$0.01 per share, 975,150 shares authorized; no shares issued  | 0                  | 0               |
| Series A preferred stock, par value \$0.01 per share, 24,850 shares authorized; no shares issued  | 0                  | 0               |
| Common stock, non-voting, par value \$0.01 per share, 10,000,000 shares authorized; no shares issued  | 0                  | 0               |
| Common stock, par value \$0.01 per share, 30,000,000 shares authorized; 20,417,420 shares issued and 20,383,055 outstanding in 2013 and 20,190,116 shares issued and 20,155,268 outstanding in 2012 | 204                | 202             |

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|   |           |           |
|---|-----------|-----------|
| Additional paid-in capital  | 150,022   | 149,576   |
| Retained deficit  | (74,038 ) | (65,282 ) |
| Accumulated other comprehensive loss                                    | (21,110 ) | (21,562 ) |
| Treasury stock, 34,365 and 34,848 shares in 2013 and 2012, respectively | (1 )      | (1 )      |
| Total stockholders' equity  | 55,077    | 62,933    |
| Total liabilities and stockholders' equity                              | \$165,723 | \$160,968 |

The accompanying notes are an integral part of the consolidated financial statements.



**Sypris Solutions, Inc.****Consolidated Cash Flow Statements****(in thousands)**

|  | <b>Six Months Ended</b> |                |
|--|-------------------------|----------------|
|  | <b>June 30,</b>         | <b>July 1,</b> |
|  | <b>2013</b>             | <b>2012</b>    |
|  | <b>(Unaudited)</b>      |                |
| Cash flows from operating activities:  |                         |                |
| Net (loss) income  | \$(7,953 )              | \$9,726        |
| Loss from discontinued operations  | 0                       | (799 )         |
| (Loss) income from continuing operations   | (7,953 )                | 10,525         |
| Adjustments to reconcile net (loss) income to net cash used in operating activities: |                         |                |
| Depreciation and amortization  | 6,168                   | 6,128          |
| Gain on sale of marketable securities  | 0                       | (537 )         |
| Stock-based compensation expense   | 1,002                   | 925            |
| Deferred revenue recognized  | (4,000 )                | (3,946 )       |
| Deferred loan costs recognized   | 39                      | 39             |
| Gain on sale of assets   | (1,682 )                | (2,625 )       |
| Provision for excess and obsolete inventory  | 926                     | 610            |
| Goodwill impairment  | 6,900                   | 0              |
| Other noncash items  | 472                     | 358            |
| Contributions to pension plans   | (217 )                  | (446 )         |
| Change in operating assets and liabilities:  |                         |                |
| Accounts receivable  | (14,375 )               | (20,375 )      |
| Inventory  | (5,121 )                | (6,393 )       |
| Prepaid expenses and other assets  | 931                     | (972 )         |
| Accounts payable   | 16,101                  | 10,777         |
| Accrued and other liabilities  | (144 )                  | 1,101          |
| Net cash used in operating activities  | (953 )                  | (4,831 )       |
| Cash flows from investing activities:  |                         |                |
| Capital expenditures, net  | (1,526 )                | (2,430 )       |
| Proceeds from the sale of assets   | 2,160                   | 4,542          |
| Net cash provided by investing activities  | 634                     | 2,112          |
| Cash flows from financing activities:  |                         |                |
| Net change in debt under revolving credit agreements                                 | 1,000                   | 4,000          |
| Common stock repurchases   | 0                       | (46 )          |

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|  |          |          |
|--|----------|----------|
| Indirect repurchase of shares for minimum statutory tax withholdings | (554 )   | (462 )   |
| Cash dividends paid  | (400 )   | (397 )   |
| Net cash provided by financing activities                            | 46       | 3,095    |
| Net (decrease) increase in cash and cash equivalents                 | (273 )   | 376      |
| Cash and cash equivalents at beginning of period                     | 18,664   | 18,173   |
| Cash and cash equivalents at end of period                           | \$18,391 | \$18,549 |

The accompanying notes are an integral part of the consolidated financial statements.

**Sypris Solutions, Inc.**

**Notes to Consolidated Financial Statements**

**(1) Nature of Business**

All references to “Sypris,” the “Company,” “we” or “our” include Sypris Solutions, Inc. and its wholly-owned subsidiaries. Sypris is a diversified provider of outsourced services and specialty products. The Company performs a wide range of manufacturing, engineering, design, and other technical services, typically under multi-year, sole-source contracts with corporations and government agencies in the markets for truck components and assemblies and aerospace and defense electronics. The Company provides such services through its Industrial and Electronics Groups (Note 10).

**(2) Basis of Presentation**

The accompanying unaudited consolidated financial statements include the accounts of Sypris Solutions, Inc. and its wholly-owned subsidiaries, and have been prepared by the Company in accordance with the rules and regulations of the Securities and Exchange Commission. The Company’s operations are domiciled in the United States (U.S.), Mexico, Denmark and the U.K. and serve a wide variety of domestic and international customers. All intercompany transactions and accounts have been eliminated. These unaudited consolidated financial statements reflect, in the opinion of management, all material adjustments (which include only normal recurring adjustments) necessary to fairly state the results of operations, financial position and cash flows for the periods presented, and the disclosures herein are adequate to make the information presented not misleading. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Actual results for the three and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, and notes thereto, for the year ended December 31, 2012 as presented in the Company’s Annual Report on Form 10-K.

**(3) Recent Accounting Pronouncements**

In February 2013, the FASB issued Accounting Standards Update No. 2013-02, *Comprehensive Income (Topic 220)—Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* (ASU 2013-02), to improve the reporting of reclassifications out of accumulated other comprehensive income. ASU 2013-02 requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the

respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety from accumulated other comprehensive income to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The updated guidance is to be applied prospectively, effective January 1, 2013. The adoption of this update concerns disclosure only and did not have any financial impact on our results of operations or financial position.

**(4) Goodwill**

Goodwill is tested for impairment annually as of December 31 or more frequently if impairment indicators arise. If impairment indicators arise, a step one assessment is performed to identify any possible goodwill impairment in the period in which the indicator is identified. The December 31, 2012 review of goodwill indicated that goodwill was not impaired. Beginning in March 2013, we noted certain indicators relating to our Electronics Group reporting unit that were significant enough to conclude that an impairment indicator existed as of March 31, 2013. Specifically, the Company experienced emerging uncertainty regarding certain key programs within the Electronics Group's space business beginning in the latter part of the first quarter, as one key customer communicated its strategic sourcing decision to begin insourcing programs that had been previously outsourced to the Electronics Group. Overall, the Electronics Group has been more impacted by declines in the overall government defense market than originally anticipated as the effects of sequestration have become clearer since its initial effective date on March 1, 2013. For example, sales of certain data recording products were significantly reduced due to the impact of sequestration on our customers, and the loss of commercial space business was due in part to our customer's efforts to offset unrelated losses of government business due to sequestration. As a result, the Electronics Group's short term revenue forecasts were materially affected.

For purposes of the interim goodwill impairment analysis, the Company assesses recoverability using a discounted cash flow analysis. The analysis is based upon available information regarding expected future cash flows for each reporting unit, discounted at rates consistent with the cost of capital specific to the reporting unit. A growth rate is used to calculate the terminal value of the reporting unit and is added to the present value of the forecasted cash flows. The growth rate is the expected rate at which a reporting unit's cash flow is projected to grow beyond the period covered by the long-range plan.

The sum of the calculated fair values of each reporting unit is then reconciled and compared to our total market capitalization, allowing for a reasonable control premium. If the discounted cash flow analysis yields a fair value estimate less than the reporting unit's carrying value, we proceed to step two in considering whether goodwill may be impaired. In the second step, the implied fair value of the reporting unit's goodwill is determined by allocating the reporting unit's fair value to all of the identified assets and liabilities of the reporting unit. As part of this process, the Company reviewed the recoverability of the Electronics Group's short-term and long-term assets excluding goodwill and concluded that no impairment of these assets was necessary.

The cash flow analysis, discount rate and terminal value all requires significant judgment and significantly influence in our evaluation of each reporting unit and its estimated fair value. In selecting these and other assumptions for each business, we consider historical performance, forecasted operating results, expected changes in product mix, general market conditions and industry considerations specific to the business. We make significant assumptions and estimates about the extent and timing of future cash flows, growth rates and discount rates. The cash flows are estimated over a future period of time, which makes those estimates and assumptions inherently subject to a high degree of uncertainty.

Key assumptions used to determine the fair value of the Electronics Group included the expected after-tax cash flows for the period from 2013 to 2017 and a terminal growth rate of 3.0%, which is consistent with historical expectations. Our analysis also included a comparison of our market capitalization to the estimated fair value for the entire enterprise. Significant assumptions utilized during the valuation process are impacted by economic conditions and expectations of management and may change in the future based on period-specific facts and circumstances.

The first step of the impairment test indicated that the estimated fair value for the Electronics Group was less than its carrying value as of March 31, 2013. We performed step two of the impairment test and determined that the implied goodwill for the reporting unit was lower than its value as of March 31, 2013. As a result, a non-cash impairment charge of \$6,900,000 was recorded during the three months ended March 31, 2013 to impair the goodwill associated with the Electronics Group reporting unit. The impairment charge has been presented separately in the consolidated statement of operations and fully impairs the carrying amount of goodwill related to the Electronics Group. The fair value of the Electronics Group and the assets and liabilities identified in the step two impairment test were determined using the combination of the income approach and the market approach, which are Level 3 and Level 2 inputs, respectively.

**(5) Discontinued Operations**

On October 26, 2009, the Company sold all of the stock of its wholly owned subsidiary, Sypris Test & Measurement, Inc., for \$39,000,000. During 2010, the Company was made aware of a potential indemnification claim from the purchaser of Sypris Test & Measurement. The parties engaged in binding arbitration during July 2012 to resolve the claim, and the dispute was settled for \$6,500,000, which included the counterparty's legal fees and expenses. Both parties entered a mutual release of all related potential claims. The Company also incurred legal expenses of \$576,000 and \$799,000 during the three and six months ended July 1, 2012 in connection with the claim. These charges are included in loss from discontinued operations, net of tax in the consolidated statements of operations.

**(6) Other (Income), Net**

During the three and six months ended June 30, 2013, the Company recognized net gains of \$17,000 and \$1,682,000, respectively, related to the disposition of idle assets. Additionally, the Company recognized foreign currency translation gains of \$187,000 and losses of \$386,000 for the three and six months ended June 30, 2013, respectively, related to the U.S. dollar denominated monetary asset position of our Mexican subsidiary for which the Mexican peso is the functional currency. For the three and six months ended July 1, 2012, the Company recognized net gains of \$13,000 and \$2,625,000, respectively, related to the disposition of idle assets and foreign currency translation gains of \$361,000 and losses of \$245,000, respectively. These gains and losses are included in other (income), net on the consolidated statements of operations.

**(7) Dana Claim**

On March 3, 2006, the Company's largest customer, Dana Corporation ("Dana"), and 40 of its U.S. subsidiaries, filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York. On August 7, 2007, the Company entered into a comprehensive settlement agreement with Dana (the "Settlement Agreement") to resolve all outstanding disputes between the parties, terminate previously approved arbitration payments and replace three existing supply agreements with a single, revised contract running through 2014. In addition, Dana provided the Company with an allowed general unsecured non-priority claim in the face amount of \$89,900,000 (the "Claim").

The Claim provided to the Company was agreed to by the Company and Dana as consideration for the aggregate economic impact of the various elements the two parties were negotiating. After the aggregate Claim value of \$89,900,000 was established, the Company recorded the claim at the estimated fair value of \$76,483,000 and allocated the estimated fair value to each commercial issue negotiated. The revenues and resulting net income associated with each of those issues requiring the Company's continued involvement was deferred and will be recognized over the applicable period of the involvement. For the six months ended June 30, 2013 and July 1, 2012, the Company recognized revenue of \$4,000,000 and \$3,946,000, respectively, related to the Claim.

On August 31, 2011, the Company received 143,966 shares of Dana common stock, representing the final distribution to be received in conjunction with the settlement. On June 30, 2012, the Company sold 43,966 shares for net proceeds of \$556,000 and a gain of \$537,000.

**(8) (Loss) Earnings Per Common Share**

The Company computes earnings per share using the two-class method, which is an earnings allocation formula that determines earnings per share for common stock and participating securities. Restricted stock granted by the Company is considered a participating security since it contains a non-forfeitable right to dividends.

Our potentially dilutive securities include potential common shares related to our stock options and restricted stock. Diluted earnings per share considers the impact of potentially dilutive securities except in periods in which there is a loss because the inclusion of the potential common shares would have an anti-dilutive effect. Diluted earnings per share excludes the impact of common shares related to our stock options in periods in which the option exercise price is greater than the average market price of our common stock for the period. For the three and six months ended June 30, 2013, diluted weighted average common shares do not include the impact of outstanding stock options and unvested compensation-related shares because the effect of these items on diluted net loss would be anti-dilutive. There were 595,000 and 489,000 potential common shares excluded from diluted earnings per share for the three and six months ended July 1, 2012, respectively.



A reconciliation of the weighted average shares outstanding used in the calculation of basic and diluted (loss) income per common share is as follows (in thousands):

|   | <b>Three Months Ended</b> |                     | <b>Six Months Ended</b> |                     |
|---|---------------------------|---------------------|-------------------------|---------------------|
|   | <b>June 30, 2013</b>      | <b>July 1, 2012</b> | <b>June 30, 2013</b>    | <b>July 1, 2012</b> |
|   | <b>(Unaudited)</b>        |                     | <b>(Unaudited)</b>      |                     |
| Basic and Diluted Net Earnings:   |                           |                     |                         |                     |
| (Loss) income from continuing operations as reported                              | \$ (1,494 )               | \$ 5,014            | \$ (7,953 )             | \$ 10,525           |
| Less distributed and undistributed earnings allocable to restricted award holders | 0                         | (220 )              | 0                       | (423 )              |
| Less dividends declared attributable to restricted award holders                  | (12 )                     | (17 )               | (23 )                   | (30 )               |
| Net (loss) income from continuing operations allocable to common stockholders     | (1,506 )                  | 4,777               | (7,976 )                | 10,072              |
| Loss from discontinued operations, net of tax allocable to common stockholders    | 0                         | (576 )              | 0                       | (799 )              |
| Net (loss) income allocable to common stockholders                                | \$ (1,506 )               | \$ 4,201            | \$ (7,976 )             | \$ 9,273            |
| Weighted average shares outstanding-basic   | 19,347                    | 19,068              | 19,255                  | 19,020              |
| Weighted average additional shares assuming conversion of potential common shares | 0                         | 365                 | 0                       | 341                 |
| Weighted average shares outstanding - diluted                                     | 19,347                    | 19,433              | 19,255                  | 19,361              |
| Basic (loss) income per common share attributable to stockholders:                |                           |                     |                         |                     |
| Continuing operations   | \$ (0.08 )                | \$ 0.25             | \$ (0.41 )              | \$ 0.53             |
| Discontinued operations   | 0.00                      | (0.03 )             | 0.00                    | (0.04 )             |
| Net (loss) income   | \$ (0.08 )                | \$ 0.22             | \$ (0.41 )              | \$ 0.49             |
| Diluted (loss) income per common share attributable to stockholders:              |                           |                     |                         |                     |
| Continuing operations   | \$ (0.08 )                | \$ 0.25             | \$ (0.41 )              | \$ 0.52             |
| Discontinued operations   | 0.00                      | (0.03 )             | 0.00                    | (0.04 )             |
| Net (loss) income   | \$ (0.08 )                | \$ 0.22             | \$ (0.41 )              | \$ 0.48             |

**(9) Inventory**

Inventory consisted of the following (in thousands):

**June 30,**

|   | <b>2013</b>        | <b>December<br/>31,</b> |
|---|--------------------|-------------------------|
|   | <b>(Unaudited)</b> | <b>2012</b>             |
| Raw materials                             | \$ 19,917          | \$ 20,645               |
| Work in process                           | 16,507             | 14,198                  |
| Finished goods                            | 7,849              | 4,461                   |
| Reserve for excess and obsolete inventory | (6,113 )           | (5,346 )                |
|   | \$ 38,160          | \$ 33,958               |

**(10) Segment Data**

The Company is organized into two business groups, the Industrial Group and the Electronics Group. The segments are each managed separately because of the distinctions between products, services, markets, customers, technologies and workforce skills of the segments. The Industrial Group provides manufacturing services for a variety of customers that outsource forged and finished steel components and subassemblies. The Industrial Group also manufactures high-pressure closures and other fabricated products. The Electronics Group provides manufacturing and technical services as an outsourced service provider and manufactures complex data storage systems. There was no intersegment net revenue recognized in any of the periods presented.

The following table presents financial information for the reportable segments of the Company (in thousands):

|  | <b>Three Months Ended</b> |                | <b>Six Months Ended</b> |                |
|--|---------------------------|----------------|-------------------------|----------------|
|  | <b>June 30,</b>           | <b>July 1,</b> | <b>June 30,</b>         | <b>July 1,</b> |
|  | <b>2013</b>               | <b>2012</b>    | <b>2013</b>             | <b>2012</b>    |
|  | <b>(Unaudited)</b>        |                | <b>(Unaudited)</b>      |                |
| Net revenue from unaffiliated customers: |                           |                |                         |                |
| Industrial Group                         | \$74,432                  | \$82,850       | \$145,581               | \$165,372      |
| Electronics Group                        | 7,734                     | 16,062         | 14,996                  | 30,003         |
|  | \$82,166                  | \$98,912       | \$160,577               | \$195,375      |
| Gross profit (loss):                     |                           |                |                         |                |
| Industrial Group                         | \$8,858                   | \$8,906        | \$16,968                | \$18,828       |
| Electronics Group                        | (522 )                    | 4,317          | (556 )                  | 6,909          |
|  | \$8,336                   | \$13,223       | \$16,412                | \$25,737       |
| Operating income (loss):                 |                           |                |                         |                |
| Industrial Group                         | \$5,976                   | \$6,097        | \$11,361                | \$13,453       |
| Electronics Group                        | (4,444 )                  | 724            | (14,595 )               | 460            |
| General, corporate and other             | (2,221 )                  | (2,353 )       | (4,336 )                | (4,942 )       |
|  | \$(689 )                  | \$4,468        | \$(7,570 )              | \$8,971        |

|                   | <b>June 30,</b>    | <b>December 31,</b> |
|-------------------|--------------------|---------------------|
|                   | <b>2013</b>        | <b>2012</b>         |
|                   | <b>(Unaudited)</b> |                     |
| Total assets:     |                    |                     |
| Industrial Group  | \$ 121,857         | \$ 114,268          |
| Electronics Group | 30,522             | 38,852              |

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|                             |            |            |
|-----------------------------|------------|------------|
| General corporate and other | 13,344     | 7,848      |
|                             | \$ 165,723 | \$ 160,968 |

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**(11) Commitments and Contingencies**

The provision for estimated warranty costs is recorded at the time of sale and periodically adjusted to reflect actual experience. The Company's warranty liability, which is included in accrued liabilities in the accompanying balance sheets, as of June 30, 2013 and December 31, 2012 was \$1,034,000 and \$1,111,000, respectively. The Company's warranty expense for the six months ended June 30, 2013 and July 1, 2012 was \$136,000 and \$221,000, respectively.

Additionally, the Company sells three and five-year extended warranties for one of its link encryption products. The revenue from the extended warranties is deferred and recognized ratably over the contractual term. As of June 30, 2013 and December 31, 2012, the Company had deferred \$2,187,000 and \$2,607,000, respectively, related to extended warranties.

The Company bears insurance risk as a member of a group captive insurance entity for certain general liability, automobile and workers' compensation insurance programs and a self-insured employee health program. The Company records estimated liabilities for its insurance programs based on information provided by the third-party plan administrators, historical claims experience, expected costs of claims incurred but not paid, and expected costs to settle unpaid claims. The Company monitors its estimated insurance-related liabilities on a quarterly basis. As facts change, it may become necessary to make adjustments that could be material to the Company's consolidated results of operations and financial condition. The Company believes that its present insurance coverage and level of accrued liabilities are adequate.

From time to time, the Company is involved in certain litigation and contract issues arising in the normal course of business. While the outcome of these matters cannot, at this time, be predicted in light of the uncertainties inherent therein, management does not expect that these matters will have a material adverse effect on the consolidated financial position or results of operations of the Company.

As of June 30, 2013, the Company had outstanding purchase commitments of approximately \$7,436,000, primarily for the acquisition of inventory and manufacturing equipment. As of June 30, 2013, the Company also had outstanding letters of credit of \$806,000 primarily under the aforementioned captive insurance program.

**(12) Income Taxes**

The provision for income taxes includes federal, state, local and foreign taxes. The Company's effective tax rate varies from period to period due to the proportion of foreign and domestic pre-tax income expected to be generated by the

Company. The Company provides for income taxes for its domestic operations at a statutory rate of 35% and for its foreign operations at a statutory rate of 30% in 2013 and 2012. The Company's foreign operations are also subject to minimum income taxes in periods where positive cash flows exceed taxable income. Reconciling items between the federal statutory rate and the effective tax rate also include the expected usage of federal net operating loss carryforwards, state income taxes, valuation allowances and certain other permanent differences.

The Company recognizes liabilities or assets for the deferred tax consequences of temporary differences between the tax basis of assets or liabilities and their reported amounts in the financial statements in accordance with ASC 740, *Income Taxes*. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of assets or liabilities are recovered or settled. ASC 740 requires that a valuation allowance be established when it is more likely than not that all or a portion of a deferred tax asset will not be realized. The Company evaluates its deferred tax position on a quarterly basis and valuation allowances are provided as necessary. During this evaluation, the Company reviews its forecast of income in conjunction with other positive and negative evidence surrounding the realizability of its deferred tax assets to determine if a valuation allowance is needed. Based on the current forecast, the Company has established a valuation allowance against the domestic net deferred tax asset. Until an appropriate level and characterization of profitability is attained, the Company expects to continue to maintain a valuation allowance on its net deferred tax assets related to future U.S. and certain non-U.S. tax benefits.

The Company expects to repatriate available non-U.S. cash holdings in 2013 and 2014 to support management's strategic objectives and fund ongoing U.S. operational cash flow requirements; therefore current earnings from non-U.S. operations are not treated as permanently reinvested. The U.S. income tax recorded in 2013 on these non-U.S. earnings is expected to be offset by the benefit of a partial release of a valuation allowance on U.S. net operating loss carryforwards. Should the U.S. valuation allowance be released at some future date, the U.S. tax on foreign earnings not permanently reinvested may have a material effect on our effective tax rate. For the year ending December 31, 2013, the Company expects any additional tax expense from non-U.S. withholding and other taxes expected to be incurred on the repatriation of current earnings will not be material.

**(13) Employee Benefit Plans**

Pension (benefit) expense consisted of the following (in thousands):

|   | <b>Three Months Ended</b> |                | <b>Six Months Ended</b> |                |
|---|---------------------------|----------------|-------------------------|----------------|
|   | <b>June 30,</b>           | <b>July 1,</b> | <b>June 30,</b>         | <b>July 1,</b> |
|   | <b>2013</b>               | <b>2012</b>    | <b>2013</b>             | <b>2012</b>    |
|   | <b>(Unaudited)</b>        |                | <b>(Unaudited)</b>      |                |
| Service cost                                  | \$5                       | \$10           | \$12                    | \$20           |
| Interest cost on projected benefit obligation | 410                       | 466            | 826                     | 932            |
| Net amortizations, deferrals and other costs  | 200                       | 201            | 412                     | 402            |
| Expected return on plan assets                | (631)                     | (608)          | (1,261)                 | (1,216)        |
|   | <b>\$(16 )</b>            | <b>\$69</b>    | <b>\$(11 )</b>          | <b>\$138</b>   |

**(14) Accumulated Other Comprehensive Loss**

The Company's accumulated other comprehensive loss consists of employee benefit-related adjustments and foreign currency translation adjustments.

Accumulated other comprehensive loss consisted of the following (in thousands):

|  | <b>June 30,</b>     | <b>December 31,</b> |
|--|---------------------|---------------------|
|  | <b>2013</b>         | <b>2012</b>         |
|  | <b>(Unaudited)</b>  |                     |
| Foreign currency translation adjustments                           | \$ (4,223 )         | \$ (4,675 )         |
| Employee benefit-related adjustments, net of tax of \$2,512 – U.S. | (16,561 )           | (16,561 )           |
| Employee benefit-related adjustments – Mexico                      | (326 )              | (326 )              |
| Accumulated other comprehensive loss                               | <b>\$ (21,110 )</b> | <b>\$ (21,562 )</b> |

**(15) Fair Value of Financial Instruments**

Cash, accounts receivable, accounts payable and accrued liabilities are reflected in the consolidated financial statements at their carrying amount which approximates fair value because of the short-term maturity of those instruments. The carrying amount of debt outstanding at June 30, 2013 and December 31, 2012 under the Company's credit facility entered into on May 12, 2011 (the "Credit Facility") approximates fair value because the borrowing interest rates are for terms of less than six months and have rates that reflect currently available terms and conditions for similar debt.



## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Overview

We are a diversified provider of outsourced services and specialty products. We perform a wide range of manufacturing, engineering, design and other technical services, typically under multi-year, sole-source contracts with corporations and government agencies principally in the markets for industrial manufacturing and aerospace and defense electronics.

We are organized into two business groups, the Industrial Group and the Electronics Group. The Industrial Group, which is comprised of Sypris Technologies, Inc. and its subsidiaries, generates revenue primarily from the sale of manufacturing services to customers in the market for truck components and assemblies and from the sale of products to the energy and chemical markets. The Electronics Group, which is comprised of Sypris Electronics, LLC and its subsidiary, generates revenue primarily from the sale of manufacturing services, technical services and products to customers in the market for aerospace and defense electronics.

We focus on those markets where we have the expertise, qualifications and leadership position to sustain a competitive advantage. We target our resources to support the needs of industry leaders that embrace multi-year contractual relationships as a strategic component of their supply chain management. These contracts, many of which are sole-source by part number and, historically, have been renewed for terms of five years or more, enable us to invest in leading-edge processes or technologies to help our customers remain competitive. The productivity, flexibility and economies of scale that can result offer an important opportunity for differentiating ourselves from our competitors when it comes to cost, quality, reliability and customer service.

During the past few years, we have significantly improved our financial condition by reducing fixed costs, accelerating integration efficiencies, exiting certain unprofitable product lines, selling idle assets, selling the stock of Sypris Test & Measurement, Inc., liquidating our holding in Dana common stock and entering into a new, more favorable debt facility.

However, we continue to face challenges within the Electronics Group, such as the conclusion of several U.S. Department of Defense programs that the Company supported as a subcontractor, the loss of a key commercial space customer who decided to begin insourcing programs that had been previously outsourced to the Electronics Group, the uncertainty in the worldwide macroeconomic climate and its impact on aerospace and defense spending patterns globally, the emergence of new competitors to our core product offerings, as well as federal government spending uncertainties in the U.S.

The Electronics Group's revenue has declined year-over-year since 2009 primarily due to the completion of certain electronic manufacturing and engineering services programs and the timing and amount of certain contract awards by the U.S. Department of Defense and subsequently by its prime contractors on programs that the Company supports. While we do not have a pipeline of programs or other contract awards to fully replace these completed programs in the near term, the Company is currently developing new products and pursuing new programs to replenish its revenue stream within the Electronics Group. The U.S. government's continued focus on addressing federal budget deficits and the growing national debt exacerbates this challenging environment for the Electronics Group. In addition, the Budget Control Act of 2011 (the "Budget Control Act") commits the U.S. Government to reduce the federal deficit by \$1.2 trillion over ten years through a combination of automatic, across-the-board spending cuts and caps on discretionary spending. This "sequestration" under the Budget Control Act is split equally between defense and non-defense programs and went into effect starting March 2013. Therefore, while defense spending is expected to continue to constitute a significant portion of the federal budget in the future, overall defense spending levels may drop substantially in the near term and over time. Congress and the Administration continue to debate these issues. We expect that certain military and defense programs will experience delays while the receipt of government approvals remains pending. Additionally, furloughs could cause delays in a variety of areas, including contract payment processing and approvals. We continue to monitor this process and work with our suppliers and customers to understand the potential impact on the Company.

As a result, the Company expects ongoing uncertainty and the potential for further revenue declines within this market for at least the next twelve months. For the longer term, we are continuing to evaluate investments in new products and programs to further improve the attractiveness of our business portfolio, with a specific emphasis on trusted solutions for identity management, cryptographic key distribution and cyber analytics. There can be no assurance that the Company's efforts to introduce new products and services or reduce its cost structure will be sufficient to offset the impact of lower revenues. Should revenues decrease further in the coming periods, the Company might be required to implement further cost reductions or other downsizing measures, which could be costly and adversely impact our financial performance.

## Results of Operations

The tables below compare our segment and consolidated results for the three and six month periods of operations of 2013 to the three and six month periods of operations of 2012. The tables present the results for each period, the change in those results from 2012 to 2013 in both dollars and percentage change and the results for each period as a percentage of net revenue.

The first two data columns in each table show the absolute results for each period presented.

The columns entitled “Year Over Year Change” and “Year Over Year Percentage Change” show the change in results, both in dollars and percentages. These two columns show favorable changes as positive and unfavorable changes as negative. For example, when our net revenue increases from one period to the next, that change is shown as a positive number in both columns. Conversely, when expenses increase from one period to the next, that change is shown as a negative number in both columns.

The last two columns in each table show the results for each period as a percentage of net revenue. In these two columns, the cost of sales and gross profit for each are given as a percentage of that segment’s net revenue. These amounts are shown in italics.

In addition, as used in the table, “NM” means “not meaningful.”

## Three Months Ended June 30, 2013 Compared to Three Months Ended July 1, 2012

|  | Three Months Ended |              | Year Over Year                 |                                | Results as Percentage of                             |   |
|--|--------------------|--------------|--------------------------------|--------------------------------|--|---|
|  | June 30, 2013      | July 1, 2012 | Change Favorable (Unfavorable) | Change Favorable (Unfavorable) | Net Revenue for the Three Months Ended June 30, 2013 | Net Revenue for the Three Months Ended July 1, 2012 |
| <b>(in thousands, except percentage data)</b>          |                    |              |                                |                                |  |   |
| Net revenue:   |                    |              |                                |                                |  |   |
| Industrial Group                                       | \$74,432           | \$82,850     | \$ (8,418 )                    | (10.2 )%                       | 90.6 %   | 83.8 %  |
| Electronics Group                                      | 7,734              | 16,062       | (8,328 )                       | (51.8 )                        | 9.4  | 16.2  |
| Total  | 82,166             | 98,912       | (16,746 )                      | (16.9 )                        | 100.0  | 100.0   |
| Cost of sales:   |                    |              |                                |                                |  |   |
| Industrial Group                                       | 65,574             | 73,944       | 8,370                          | 11.3                           | 88.1   | 89.3  |
| Electronics Group                                      | 8,256              | 11,745       | 3,489                          | 29.7                           | 106.7  | 73.1  |
| Total  | 73,830             | 85,689       | 11,859                         | 13.8                           | 89.9   | 86.6  |
| Gross profit (loss):                                   |                    |              |                                |                                |  |   |
| Industrial Group                                       | 8,858              | 8,906        | (48 )                          | (0.5 )                         | 11.9   | 10.7  |
| Electronics Group                                      | (522 )             | 4,317        | (4,839 )                       | (112.1 )                       | (6.7 )   | 26.9  |
| Total  | 8,336              | 13,223       | (4,887 )                       | (37.0 )                        | 10.1   | 13.4  |
| Selling, general and administrative                    | 7,598              | 7,698        | 100                            | 1.3                            | 9.2  | 7.8   |
| Research and development                               | 1,419              | 1,035        | (384 )                         | (37.1 )                        | 1.7  | 1.0   |
| Amortization of intangible assets                      | 8                  | 22           | 14                             | 63.6                           | —  | —   |
| Operating (loss) income                                | (689 )             | 4,468        | (5,157 )                       | NM                             | (0.8 )   | 4.5   |
| Interest expense, net                                  | 120                | 105          | (15 )                          | (14.3 )                        | 0.1  | 0.1   |
| (Gain) on the sale of marketable securities            | —                  | (537)        | (537 )                         | NM                             | —  | (0.5 )  |
| Other (income), net                                    | (259 )             | (457)        | (198 )                         | (43.3 )                        | (0.3 )   | (0.5 )  |
| (Loss) income from continuing operations, before taxes | (550 )             | 5,357        | (5,907 )                       | NM                             | (0.6 )   | 5.4   |
| Income tax expense                                     | 944                | 343          | (601 )                         | (175.2 )                       | 1.2  | 0.3   |
| (Loss) income from continuing operations               | (1,494 )           | 5,014        | (6,508 )                       | NM                             | (1.8 )   | 5.1   |
| Loss from discontinued operations, net of tax          | —                  | (576)        | 576                            | NM                             | —  | (0.6 )  |
| Net (loss) income                                      | \$(1,494 )         | 4,438        | (5,932 )                       | NM                             | (1.8 )   | 4.5 %   |

## Six Months Ended June 30, 2013 Compared to Six Months Ended July 1, 2012

|  | Six Months Ended                       |           | Year Over     | Year Over     | Results as    |         |
|--|--|-----------|---------------|---------------|---------------|---------|
|  | June 30,                               | July 1,   | Change        | Percentage    | Percentage of |         |
|  | 2013                                   | 2012      | (Unfavorable) | (Unfavorable) | June 30,      | July 1, |
|  | (in thousands, except percentage data) |           |               |               |               |         |
| Net revenue:   |  |           |               |               |               |         |
| Industrial Group                                       | \$145,581                              | \$165,372 | \$ (19,791 )  | (12.0 )%      | 90.7 %        | 84.6 %  |
| Electronics Group                                      | 14,996                                 | 30,003    | (15,007 )     | (50.0 )       | 9.3           | 15.4    |
| Total  | 160,577                                | 195,375   | (34,798 )     | (17.8 )       | 100.0         | 100.0   |
| Cost of sales:   |  |           |               |               |               |         |
| Industrial Group                                       | 128,613                                | 146,544   | 17,931        | 12.2          | 88.3          | 88.6    |
| Electronics Group                                      | 15,552                                 | 23,094    | 7,542         | 32.7          | 103.7         | 77.0    |
| Total  | 144,165                                | 169,638   | 25,473        | 15.0          | 89.8          | 86.8    |
| Gross profit (loss):                                   |  |           |               |               |               |         |
| Industrial Group                                       | 16,968                                 | 18,828    | (1,860 )      | (9.9 )        | 11.7          | 11.4    |
| Electronics Group                                      | (556 )                                 | 6,909     | (7,465 )      | (108.0 )      | (3.7 )        | 23.0    |
| Total  | 16,412                                 | 25,737    | (9,325 )      | (36.2 )       | 10.2          | 13.2    |
| Selling, general and administrative                    | 14,756                                 | 15,293    | 537           | 3.5           | 9.2           | 7.8     |
| Research and development                               | 2,296                                  | 1,429     | (867 )        | (60.7 )       | 1.4           | 0.7     |
| Amortization of intangible assets                      | 30                                     | 44        | 14            | 31.8          | —             | —       |
| Impairment of goodwill                                 | 6,900                                  | —         | (6,900 )      | NM            | 4.3           | —       |
| Operating (loss) income                                | (7,570 )                               | 8,971     | (16,541 )     | NM            | (4.7 )        | 4.6     |
| Interest expense, net                                  | 266                                    | 222       | (44 )         | (19.8 )       | 0.2           | 0.1     |
| (Gain) on the sale of marketable securities            | —                                      | (537 )    | (537 )        | NM            | —             | (0.3 )  |
| Other (income), net                                    | (1,454 )                               | (2,531 )  | (1,077 )      | (42.6 )       | (0.9 )        | (1.3 )  |
| (Loss) income from continuing operations, before taxes | (6,382 )                               | 11,817    | (18,199 )     | NM            | (4.0 )        | 6.0     |
| Income tax expense                                     | 1,571                                  | 1,292     | (279 )        | (21.6 )       | 1.0           | 0.6     |
| (Loss) income from continuing operations               | (7,953 )                               | 10,525    | (18,478 )     | NM            | (5.0 )        | 5.4     |
| Loss from discontinued operations, net of tax          | —                                      | (799 )    | 799           | NM            | —             | (0.4 )  |
| Net (loss) income                                      | \$(7,953 )                             | \$9,726   | \$ (17,679 )  | NM            | (5.0 )%       | 5.0 %   |

*Net Revenue.* The Industrial Group derives its revenue from manufacturing services and product sales. Net revenue in the Industrial Group for the three and six month periods ended June 30, 2013 decreased \$8.4 million and \$19.8 million from the prior year comparable periods, respectively. Decreased volumes for commercial truck components resulted in decreased revenue of approximately \$8.2 million and \$18.2 million for the three and six month periods, respectively. Decreased trailer volumes resulted in decreased revenue of approximately \$1.3 million and \$2.1 million for the three and six month periods, respectively. Decreased volumes for the off-highway business resulted in decreased revenue of \$0.5 million and \$1.1 million for the three and six month periods, respectively. Partially offsetting these decreases was an increase in sales of specialty products of approximately \$1.5 million and \$0.5 million for the three and six month periods, respectively. Additionally, increased steel prices, which are contractually passed through to customers under certain contracts, and pricing adjustments resulted in increased revenue of approximately \$1.1 million for the six month period ended June 30, 2013.

The Electronics Group derives its revenue from product sales and technical outsourced services. Net revenue in the Electronics Group for the three and six month periods ended June 30, 2013 decreased \$8.3 million and \$15.0 million from the prior year comparable periods, respectively, primarily due to the loss of certain electronic manufacturing and engineering services programs. The Company is currently developing new products and pursuing new programs to replenish its revenue stream within the Electronics Group; however, commercializing the new products and programs has been slower than anticipated and is not expected to result in significant revenue in 2013. Additionally, the Company's outlook continues to be negatively affected by budgetary and funding uncertainty within the U.S. Department of Defense.

*Gross Profit.* The Industrial Group's gross profit decreased to \$8.9 million and \$17.0 million in the three and six month periods ended June 30, 2013, respectively, from \$8.9 million and \$18.8 million in the prior year comparable periods. The net decrease in sales volumes across the previously discussed product and service offerings resulted in a decrease in gross profit of approximately \$1.1 million and \$3.5 million for the three and six month periods, respectively. The Industrial Group also realized a decrease in gross profit of \$0.6 million and \$1.3 million for the three and six month periods ended June 30, 2013, respectively, as a result of higher wages, increased utilities and the strengthening of the Mexican peso. Partially offsetting this was an increase in gross profit of \$1.6 million and \$2.9 million from productivity improvements.

The Electronics Group's gross profit decreased to losses of \$0.5 million and \$0.6 million in the three and six month periods ended June 30, 2013, respectively, from profit of \$4.3 million and \$6.9 million in the prior year comparable periods. The decline in gross profit was primarily as a result of lower revenues and an unfavorable mix in sales of lower margin products and services.

*Selling, General and Administrative.* Selling, general and administrative expense decreased \$0.1 million and \$0.5 million for the three and six month periods ended June 30, 2013, respectively, as compared to the same periods in 2012 as a result of a decrease in incentive compensation expenses. The Company has continued to reduce controllable general and administrative expenses.

*Research and Development.* Research and development costs increased \$0.4 million and \$0.9 million for the three and six month periods ended June 30, 2013, respectively, relative to the comparable 2012 periods. Our research and development costs in 2013 and 2012 have been primarily in support of the Electronics Group's product and technology development activities, with a specific emphasis on trusted solutions for identity management, cryptographic key distribution and cyber analytics.

*Impairment of Goodwill.* Goodwill is tested for impairment annually as of December 31 or more frequently if impairment indicators arise. If impairment indicators arise, a step one assessment is performed to identify any possible goodwill impairment in the period in which the indicator is identified. The December 31, 2012 review of goodwill indicated that goodwill was not impaired. Beginning in March 2013, we noted certain indicators relating to our

Electronics Group reporting unit that were significant enough to conclude that an impairment indicator existed. Specifically, the Company experienced emerging uncertainty regarding certain key programs within the Electronics Group's space business beginning in the latter part of the first quarter, as one key customer communicated its strategic sourcing decision to begin insourcing programs that had been previously outsourced to the Electronics Group. Overall, the Electronics Group has been more impacted by declines in the overall government defense market than originally anticipated as the effects of sequestration have become clearer since its initial effective date on March 1, 2013. For example, sales of certain data recording products were significantly reduced due to the impact of sequestration on our customers, and the loss of commercial space business was due in part to our customer's efforts to offset unrelated losses of government business due to sequestration. As a result, the Electronics Group's short term revenue forecasts were materially affected. As a result of the analysis, the Electronics Group's goodwill was deemed to be impaired, resulting in a non-cash impairment charge of \$6.9 million for the six months ended June 30, 2013, representing the segment's entire goodwill balance.

*Interest Expense.* Interest expense for the three and six months ended June 30, 2013 remained flat relative to the comparable 2012 periods. The weighted average interest rate was 2.6% and 2.5% for the three and six month periods of 2013, respectively, as compared to 2.4% and 2.5% for the three and six month periods of 2012, respectively. Additionally, our weighted average debt outstanding increased to \$9.9 million and \$13.3 million for the three and six month periods of 2013, respectively, from \$9.8 million and \$9.6 million during the three and six month periods of 2012, respectively.



*Other (Income), Net.* The Company recognized other income of \$0.3 million and \$1.5 million for the three and six months ended June 30, 2013 compared to \$0.5 million and \$2.5 million for the three and six months ended July 1, 2012. Other income, net for the six months ended June 30, 2013 includes gains of \$1.7 million from the sale of fixed assets primarily within the Industrial Group. Other income, net for the three and six months ended June 30, 2013 also includes foreign currency translation gains of \$0.2 million and losses of \$0.4 million, respectively, related to the net U.S. dollar denominated monetary asset position of our Mexican subsidiary for which the Mexican peso is the functional currency. During the six months ended July 1, 2012, the Company recognized net gains of \$2.6 million related to the disposition of idle assets. Additionally, other income, net for the three and six months ended July 1, 2012 includes foreign currency translation gains of \$0.4 million and losses of \$0.2 million, respectively.

*Income Taxes.* Income tax expense for the three and six months ended June 30, 2013 was \$0.9 million and \$1.6 million, respectively, as compared to \$0.3 million and \$1.3 million for the three and six months ended July 1, 2012, respectively. Income tax expense for the three and six months ended June 30, 2013 includes \$0.9 million and \$1.5 million, respectively, of tax on foreign operations at the statutory rate of 30% and \$0.1 million of state tax from U.S. operations. In the U.S., our recent history of operating losses does not allow us to satisfy the “more likely than not” criterion for recognition of deferred tax assets. Therefore, there is generally no federal income tax recognized on the pre-tax income or losses in the U.S. as valuation allowance adjustments offset the associated tax effect. However, the Company has provided for certain state taxes expected to be paid in the U.S. As such, our effective income tax for the three and six months ended June 30, 2013 is higher than the U.S. federal statutory rate of 35%.

For the three and six months ended July 1, 2012, our Mexican subsidiary recognized a deferred tax benefit of \$0.7 million related to the recovery of certain deferred tax assets that were previously reserved for by a valuation allowance.

*Discontinued Operations.* On October 26, 2009, the Company sold all of the stock of its wholly owned subsidiary, Sypris Test & Measurement, Inc., for \$39.0 million. During 2010, the Company was made aware of a potential indemnification claim from the purchaser of Sypris Test & Measurement. The parties engaged in binding arbitration during July 2012 to resolve the claim, and the dispute was settled for \$6.5 million, which included the counterparty’s legal fees and expenses. Both parties entered a mutual release of all related potential claims. The Company also incurred legal expenses of \$0.6 million and \$0.8 million during the three and six months ended July 1, 2012 in connection with the claim. These charges are included in loss from discontinued operations, net of tax in the consolidated statements of operations.

## **Liquidity, Capital Resources**

Borrowing availability under the Credit Facility is determined by a monthly borrowing base collateral calculation that is based on a specified percentage of the value of eligible accounts receivable, inventory and machinery and equipment, less certain reserves and subject to certain other adjustments. At June 30, 2013, we had total excess

availability under the Credit Facility of \$19.0 million along with an unrestricted cash balance of \$18.4 million, which provides for total cash and available borrowing capacity of \$37.4 million. Approximately \$5.8 million of the unrestricted cash balance relates to our Mexican subsidiaries. Standby letters of credit up to a maximum of \$5.0 million may be issued under the Credit Facility, of which \$0.8 million were issued at June 30, 2013. Obligations under the Credit Facility are guaranteed by all of our U.S. subsidiaries and are secured by a first priority lien on substantially all domestic assets of the Company.

The Credit Facility contains a number of covenants that, among other things, limit or restrict our ability to dispose of assets, incur additional indebtedness, incur guarantee obligations, engage in sale and leaseback transactions, prepay other indebtedness, modify organizational documents and certain other agreements, create restrictions affecting subsidiaries, pay dividends and other restricted payments without bank approval, create liens, make investments, make acquisitions, engage in mergers, change the nature of our business and engage in certain transactions with affiliates. In addition, if the Company's availability under the Credit Facility falls below \$6.0 million (or \$8.0 million for a period of 5 or more consecutive days), the Company must maintain a fixed charge coverage ratio of at least 1.15 to 1.00.

We also had purchase commitments totaling approximately \$7.4 million at June 30, 2013, primarily for inventory and manufacturing equipment.

There are numerous risks and uncertainties relating to the global economy and the commercial vehicle and aerospace and defense industries that could materially affect our financial condition, future results of operations and liquidity. These risks and uncertainties could result in decreased sales, limited access to credit, rising costs, increased competition, customer or supplier bankruptcies, delays in customer payment terms and acceleration of supplier payments, growing inventories and failure to meet debt covenants.

Our ability to service our indebtedness will require a significant amount of cash. Our ability to generate this cash will depend largely on future operations. Based on our current level of operations and our forecast for 2013 and 2014, we expect to be able to meet the financial covenants of our Credit Facility and have sufficient liquidity to finance our operations for at least the next twelve months. However, changing business, regulatory and economic conditions may mean that actual results will vary from our forecasts.

## **Financial Condition**

*Operating Activities.* Net cash used in operating activities was \$1.0 million in the first six months of 2013 as compared to \$4.8 million in the same period of 2012. Cash of \$14.4 million was used to finance increased accounts receivables in the first six months of 2013 resulting from higher revenues within our Industrial Group in the first half of 2013 as compared to the fourth quarter of 2012. Additionally, increases in accounts payable provided cash of \$16.1 million. Cash of \$5.1 million was used to finance an increase in inventory during the first six months of 2013, primarily to support higher volumes within our Industrial Group as compared to the fourth quarter of 2012.

*Investing Activities.* Net cash provided by investing activities was \$0.6 million for the first six months of 2013 as compared to net cash provided of \$2.1 million for the first six months of 2012. Net cash provided by investing activities for the first six months of 2013 included proceeds of \$2.2 million from the sale of idle assets primarily within the Industrial Group, partially offset by \$1.5 million of capital expenditures during the first six months of 2013. Net cash provided by investing activities for the first six months of 2012 included proceeds of \$4.5 million from the sale of certain idle assets within the Industrial Group partially offset by \$2.4 million of capital expenditures.

*Financing Activities.* Net cash provided by financing activities was cash neutral in the first six months of 2013 as compared to \$3.1 million during the first six months of 2012. We increased our debt by \$1.0 million on the Credit Facility during the first six months of 2013 as compared to \$4.0 million during the first six months of 2012. The Company also paid dividends of \$0.4 million and paid \$0.6 million for minimum statutory tax withholdings on stock-based compensation during the first six months of 2013. The Company paid dividends of \$0.4 million and paid \$0.5 million for minimum statutory tax withholdings on stock-based compensation during the first six months of 2012.

## **Critical Accounting Policies**

See the information concerning our critical accounting policies included under Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012. There have been no significant changes in our critical accounting policies during the six month period ended June 30, 2013.

## **Forward-looking Statements**

This Quarterly Report on Form 10-Q, and our other oral or written communications, contain “forward-looking” statements. These statements may include our expectations or projections about the future of our industries, business strategies, potential acquisitions or financial results and our views about developments beyond our control, including domestic or global economic conditions, trends and market developments. These statements are based on management’s views and assumptions at the time originally made, and, except as required by law, we undertake no obligation to update these statements, even if, for example, they remain available on our website after those views and assumptions have changed. There can be no assurance that our expectations, projections or views will come to pass, and undue reliance should not be placed on these forward-looking statements.

A number of significant factors could materially affect our specific business operations and cause our performance to differ materially from any future results projected or implied by our prior statements. Many of these factors are identified in connection with the more specific descriptions contained throughout this report. Other factors which could also materially affect such future results currently include: declining revenues and backlog in our aerospace and defense business lines as we attempt to transition from legacy products and services into new market segments and technologies; our ability to successfully develop, launch or sustain new products and programs within the Electronics Group especially in new market segments and technologies; dependence on, retention or recruitment of key employees especially in challenging markets; reliance on major customers or suppliers, especially in the automotive or aerospace and defense electronics sectors, including the risk of negative outcomes in contract renewal negotiations; adverse impacts of new technologies or other competitive pressures which increase our costs or erode our margins; the costs of compliance with our auditing, regulatory or contractual obligations; potential impairments, non-recoverability or write-offs of assets or deferred costs; inventory valuation risks including obsolescence, shrinkage, theft, overstocking or underbilling; volatility of our customers' forecasts, production levels, financial conditions, market shares, product requirements or scheduling demands; the cost, quality, timeliness, efficiency and yield of our operations and capital investments, including working capital, production schedules, cycle times, scrap rates, injuries, wages, overtime costs, freight or expediting costs; regulatory actions or sanctions (including FCPA, OSHA and Federal Acquisition Regulations, among others); potential weaknesses in internal controls over financial reporting and enterprise risk management; U.S. government spending on products and services that our Electronics Group provides, including the timing of budgetary decisions; potential liabilities associated with discontinued operations; fees, costs or other dilutive effects of refinancing, or compliance with covenants; changes in licenses, security clearances, or other legal rights to operate, manage our work force or import and export as needed; breakdowns, relocations or major repairs of machinery and equipment; pension valuation, health care or other benefit costs; labor relations; strikes; union negotiations; cyber security threats and disruptions; changes or delays in customer budgets, funding or programs; disputes or litigation involving customer, supplier, employee, lessor, landlord, creditor, stockholder, product liability or environmental claims; the costs and supply of, or access to, debt, equity capital, or insurance; cost and availability of raw materials such as steel, component parts, natural gas or utilities; failure to adequately insure or to identify environmental or other insurable risks; revised contract prices or estimates of major contract costs; risks of foreign operations; currency exchange rates; war, terrorism, or political uncertainty; unanticipated or uninsured disasters, losses or business risks; inaccurate data about markets, customers or business conditions; or unknown risks and uncertainties and the risk factors disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We are a smaller reporting company as defined in Item 10(f)(1) of Regulation S-K and thus are not required to provide the quantitative and qualitative disclosures about market risk specified in Item 305 of Regulation S-K.

### **Item 4. Controls and Procedures**

(a) *Evaluation of disclosure controls and procedures.* Based on the evaluation of our disclosure controls and procedures (as defined in Securities Exchange Act of 1934 Rules 13a-15(e) or 15d-15(e)) required by Securities Exchange Act Rules 13a-15(b) or 15d-15(b), our Chief Executive Officer and our Chief Financial Officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective.

(b) *Changes in internal controls.* There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Part II. Other Information****Item 1. Legal Proceedings**

From time to time, the Company is involved in litigation matters arising in the normal course of business. Neither we, nor any of our subsidiaries, are currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding currently threatened against us.

**Item 1A. Risk Factors**

Information regarding risk factors appears in Part I — Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Forward-Looking Statements,” in this Quarterly Report on Form 10-Q, and in Part I — Item 1A, “Risk Factors,” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012. There have been no material changes from the risk factors disclosed in our Annual Report on Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table summarizes our shares of common stock repurchased during the second quarter ended June 30, 2013 (dollars in thousands except per share data):

| Period | Total<br>Number<br>of Shares<br>Purchased<br>(a) | Average<br>Price<br>Paid per<br>Share | Total<br>Number of<br>Shares<br>Purchased<br>as a Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Dollar<br>Value of<br>Shares that<br>May Yet<br>Be<br>Purchased<br>Under the<br>Plans or<br>Programs<br>(b) |
|--------|--|---------------------------------------|--|--|
|        |  |                                       |  |  |
|        |  |                                       |  |  |

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|                       |       |         |   |          |
|-----------------------|-------|---------|---|----------|
| 4/1/2013 – 4/28/2013  | 1,072 | \$ 3.66 | — | \$ 4,340 |
| 4/29/2013 – 5/26/2013 | —     | \$ —    | — | \$ 4,340 |
| 5/27/2013 – 6/30/2013 | —     | \$ —    | — | \$ 4,340 |

The total number of shares purchased includes shares purchased under the Executive Equity Repurchase

- (a) Agreement and shares of stock withheld for the payment of withholding taxes upon the vesting of restricted stock. Common shares withheld to satisfy tax withholding obligations were immediately cancelled.

On December 20, 2011, our Board of Directors approved and we announced an authorization for the repurchase of up to \$5.0 million of our outstanding shares of common stock over the next twelve months. The Board also authorized an Executive Equity Repurchase Agreement whereby management, including officers and directors, (b) would grant the Company a first right to purchase shares at current market prices (calculated as the average of several days' closing prices). The Company's right to purchase the shares would occur any time a party to the agreement departed the Company or intended to sell more than 1,500 shares of common stock. The agreement has a five-year term, subject to earlier termination by the Company, and participation by each individual is voluntary.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.



**Item 5. Other Information**

None.

**Item 6. Exhibits**

**Exhibit**

**Number Description**

31(i).1 CEO certification pursuant to Section 302 of Sarbanes - Oxley Act of 2002.

31(i).2 CFO certification pursuant to Section 302 of Sarbanes - Oxley Act of 2002.

<sup>32</sup> CEO and CFO certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes - Oxley Act of 2002.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

**SIGNATURES**

Pursuant to the requirements 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.

SYPRIS SOLUTIONS, INC.

(Registrant)

Date: August 6, 2013 By: /s/ Brian A. Lutes  
(Brian A. Lutes)  
Vice President & Chief Financial Officer

Date: August 6, 2013 By: /s/ Rebecca R. Eckert  
(Rebecca R. Eckert)  
Controller (Principal Accounting Officer)