SYPRIS SOLUTIONS INC
Form 10-Q
August 17, 2010

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

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934
For the quarterly period ended July 4, 2010

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 (State or other jurisdiction of incorporation or organization)	61-1321992 (I.R.S. Employer Identification No.)
101 Bullitt Lane, Suite 450 Louisville, Kentucky 40222 (Address of principal executive offices) (Zip code)	(502) 329-2000 (Registrant's telephone number, including area code)

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. x Yes o 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). o Yes o 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. (Check one):

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

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

As of August 6, 2010 the Registrant had 19,673,859 shares of common stock outstanding.

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Part I. Financial Information

Item 1. Financial Statements

Sypris Solutions, Inc.

Consolidated Statements of Operations

(in thousands, except for per share data)

	Three Months Ended July 4, 2010	Three Months Ended July 5, 2009	Six Months Ended July 4, 2010	Six Months Ended July 5, 2009
	(Unaudited)		(Unaudited)	
Net revenue:				
Outsourced services	$ 58,252	$ 53,699	$ 115,251	$ 105,249
Products	4,854	15,679	10,758	31,838
Total net revenue	63,106	69,378	126,009	137,087
Cost of sales:				
Outsourced services	54,118	53,834	106,333	108,671
Products	4,057	11,101	8,732	23,419
Total cost of sales	58,175	64,935	115,065	132,090
Gross profit	4,931	4,443	10,944	4,997
Selling, general and administrative	6,983	6,994	13,558	14,740
Research and development	416	844	571	1,803
Amortization of intangible assets	28	28	56	56
Restructuring expense, net	1,002	1,732	1,415	3,713
Operating loss	(3,498)	(5,155)	(4,656)	(15,315)
Interest expense, net	583	1,449	1,184	2,160
Other income, net	(688)	(384)	(222)	(77)
Loss from continuing operations, before taxes	(3,393)	(6,220)	(5,618)	(17,398)
Income tax expense	571	413	770	768
Loss from continuing operations	(3,964)	(6,633)	(6,388)	(18,166)
Income (loss) from discontinued operations, net of tax	(300)	(145)	(300)	43
Net loss	$ (4,264)	$ (6,778)	$ (6,688)	$ (18,123)
Basic income (loss) per share:				
Loss per share from continuing operations	$ (0.21)	$ (0.36)	$ (0.34)	$ (0.98)
Loss (income) per share from discontinued operations	(0.02)	(0.01)	(0.02)	0.00
Net loss per share	$ (0.23)	$ (0.37)	$ (0.36)	$ (0.98)
Diluted income (loss) per share:				
Loss per share from continuing operations	$ (0.21)	$ (0.36)	$ (0.34)	$ (0.98)
Loss (income) per share from discontinued operations	(0.02)	(0.01)	(0.02)	0.00
Net loss per share	$ (0.23)	$ (0.37)	$ (0.36)	$ (0.98)
Weighted average shares outstanding:				
Basic	18,640	18,478	18,588	18,456
Diluted	18,640	18,478	18,588	18,456

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

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Sypris Solutions, Inc.

Consolidated Balance Sheets

(in thousands, except for share data)

	July 4, 2010 (Unaudited)	December 31, 2009 (Note)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,025	$ 15,608
Restricted cash - current	3,000	74
Accounts receivable, net	37,917	38,317
Inventory, net	32,522	29,042
Other current assets	6,398	6,406
Total current assets	94,862	89,447
Restricted cash	—	3,000
Property, plant and equipment, net	73,615	80,280
Goodwill	6,900	6,900
Other assets	9,952	10,320
Total assets	$ 185,329	$ 189,947
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 40,189	$ 36,185
Accrued liabilities	23,948	22,279
Current portion of long-term debt	3,000	4,000
Total current liabilities	67,137	62,464
Long-term debt	20,305	19,305
Other liabilities	37,790	41,960
Total liabilities	125,232	123,729
Stockholders' equity:		
Preferred stock, par value $0.01 per share, 975,150 shares authorized; no shares issued	—	—
Series A preferred stock, par value $0.01 per share, 24,850 shares authorized; no shares issued	—	—
Common stock, non-voting, par value $0.01 per share, 10,000,000 shares authorized; no shares issued	—	—
Common stock, par value $0.01 per share, 30,000,000 shares authorized; 19,970,978 shares issued and 19,673,859 shares outstanding in 2010 and 20,015,128 shares issued and 19,472,499 shares outstanding in 2009	200	200
Additional paid-in capital	148,096	147,644
Retained deficit	(71,113)	(64,434)
Accumulated other comprehensive loss	(17,083)	(17,187)
Treasury stock, 297,119 and 542,629 shares in 2010 and 2009, respectively	(3)	(5)
Total stockholders' equity	60,097	66,218
Total liabilities and stockholders' equity	$ 185,329	$ 189,947

Note: The balance sheet at December 31, 2009 has been derived from the audited consolidated financial statements at that date but does not include all information and footnotes required by accounting principles generally accepted in the United States for a complete set of financial statements.

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

Sypris Solutions, Inc.

Consolidated Cash Flow Statements

(in thousands)

	Six Months Ended July 4, 2010	July 5, 2009
	(Unaudited)	
Cash flows from operating activities:		
Net loss	$ (6,688)	$ (18,123)
(Loss) income from discontinued operations	(300)	43
Loss from continuing operations	(6,388)	(18,166)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	7,428	7,818
Stock-based compensation expense	579	398
Deferred revenue recognized	(3,056)	(3,255)
Deferred loan costs recognized	191	606
Asset impairments	—	872
Provision for excess and obsolete inventory	197	666
Other noncash items	(189)	947
Change in operating assets and liabilities:		
Accounts receivable	389	(1,018)
Inventory	(3,677)	10,920
Other current assets	8	1,888
Accounts payable	3,905	(4,263)
Accrued and other liabilities	553	(1,274)
Net cash used in operating activities – continuing operations	(60)	(3,861)
Net cash provided by operating activities – discontinued operations	—	1,947
Net cash used in operating activities	(60)	(1,914)
Cash flows from investing activities:		
Capital expenditures, net	(630)	(2,972)
Proceeds from sale of assets	71	82
Changes in nonoperating assets and liabilities	36	186
Net cash used in investing activities – continuing operations	(523)	(2,704)
Net cash used in investing activities – discontinued operations	—	(436)
Net cash used in investing activities	(523)	(3,140)
Cash flows from financing activities:		
Net change in debt under revolving credit agreements	—	2,500
Debt modification costs	—	(652)
Cash dividends paid	—	(386)
Net cash provided by financing activities	—	1,462
Net decrease in cash and cash equivalents	(583)	(3,592)
Cash and cash equivalents at beginning of period	15,608	13,717
Cash and cash equivalents at end of period	$ 15,025	$ 10,125

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

Sypris Solutions, Inc.

Notes to Consolidated Financial Statements

(1) Nature of Business

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. The Company provides such services through its Industrial and Electronics Groups.

(2) Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Sypris Solutions, Inc. and its wholly-owned subsidiaries (collectively, "Sypris" or the "Company"), and have been prepared by the Company in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. 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 July 4, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, and notes thereto, for the year ended December 31, 2009 as presented in the Company's Annual Report on Form 10-K.

Certain prior period amounts have been reclassified to conform to the current period presentation. See Note 4, Discontinued Operations.

(3) Recent Accounting Pronouncements

Any new accounting pronouncements issued but not yet effective have been deemed not to be relevant to the operations of the Company. Accordingly, the effects of any such undisclosed new accounting pronouncements are not expected to have any impact on the results of operations or financial position of the Company.

(4) Discontinued Operations

On October 26, 2009, the Company sold all of the stock of its wholly owned subsidiary, Sypris Test & Measurement, for $39,000,000, of which $3,000,000 was deposited in an 18-month escrow account in connection with certain customary representations, warranties, covenants and indemnifications of the Company. During the second quarter of 2010, the Company was made aware of a potential warranty claim from a former customer of Sypris Test & Measurement. As of July 4, 2010, the Company estimates that its total liability arising from this claim will not exceed $300,000, which has been reserved in accrued liabilities on the Company's consolidated balance sheets. There can be no assurance that similar potential claims will not emerge in the future or that relevant facts and circumstances will not change, necessitating future changes to the estimated liability. This charge is included in discontinued operations, net in the consolidated statements of operations.

The Test & Measurement business provided technical services for the calibration, certification and repair of test & measurement equipment in and outside the U.S., and prior to the sale was a part of the Company's Electronics

Group. The Company used the proceeds of $34,000,000 from the sale to reduce the amounts outstanding under its Revolving Credit Agreement and Senior Notes.

The results of the Test & Measurement segment have been reported as discontinued operations in the consolidated statements of operations for all periods presented. In accordance with the provisions of ASC 205-20-45-6 (formerly Allocation of Interest to Discontinued Operations EITF 87-24), interest expense incurred on the debt required to be repaid from the net proceeds of the sale has been allocated to discontinued operations. During the three and six month periods ended July 5, 2009, interest expense allocated to discontinued operations was $848,000 and $1,400,000, respectively, based on the $34,000,000 in debt required to be repaid as a result of the transaction.

The key components of income from discontinued operations related to the Test & Measurement segment were as follows (in thousands):

	Three Months Ended July 5, 2009 (Unaudited)	Six Months Ended July 5, 2009 (Unaudited)
Net revenue	$ 12,718	$ 26,700
Cost of sales and operating expense	(12,108)	(25,222)
Allocated interest expense	(848)	(1,400)
(Loss) income before taxes	(238)	78
Income taxes	(93)	35
(Loss) income from discontinued operations	$ (145)	$ 43

(5) 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").

Sypris and Dana conducted a series of negotiations during the period beginning March 3, 2006 and ending on the settlement date of August 7, 2007. The negotiations covered a wide range of commercial issues including compliance with the terms and conditions of past contractual matters and establishing terms and conditions for a new long-term supply agreement. Throughout these negotiations, Sypris developed and maintained a discounted cash flow valuation methodology to determine the potential economic impact to Sypris of each commercial issue under negotiation and to assign a value to each issue. The discounted cash flow valuation used the expected annual net cash flow from each commercial issue over the specific time period associated with the issue.

The Claim provided to Sypris was agreed to by Sypris and Dana as consideration for the aggregate economic impact of the various elements the two parties were negotiating. The Settlement Agreement did not specifically set forth values attributable to each of the above defined elements, nor did Sypris and Dana enter into any formal agreement as to the allocation of the Claim. Therefore, after the aggregate Claim value of $89,900,000 was established, Sypris allocated the aggregate Claim value to each commercial issue based upon the estimated net present values determined by Sypris' internal valuation methodology.

Sypris recorded the Claim at the estimated fair value of $76,483,000 on August 7, 2007 in accordance with ASC 845-10 (formerly APB 29, Accounting for Nonmonetary Transactions). Sypris allocated the estimated fair value to each commercial issue, and each of those items which required the Company's continued involvement was deferred and will be recognized over the applicable period of the involvement.

The claim entitled the Company to receive an initial distribution of 3,090,408 shares of common stock in Dana Holding Corporation ("DHC"), the right to participate in additional distributions of reserved shares of common stock of DHC if certain disputed matters are ultimately resolved for less than Dana's reserves for those matters (estimated by the Company to represent an additional 739,000 shares) and the right to receive a distribution of cash of $6,891,000.

Dana emerged from bankruptcy on January 31, 2008, and on February 1, 2008, the newly issued shares of DHC began trading on the New York Stock Exchange. During 2008, the Company received distributions of DHC common stock totaling 3,742,381 shares and a cash distribution of $6,891,000. As of July 4, 2010, the Company has received approximately 98% of the total common shares it expects to receive.

The Company determined that its investment in DHC common stock was other-than-temporarily impaired as of December 31, 2008. Accordingly, the Company recorded a $66,758,000 impairment charge during the fourth quarter of 2008. The non-cash impairment was based on DHC's closing stock price of $0.74 per share on December 31, 2008.

During the fourth quarter of 2009, the Company liquidated its holdings in DHC common stock for approximately $21,024,000 in net cash proceeds. The Company recognized a gain of $18,255,000 on the sale.

At July 4, 2010, the Company's right to participate in additional distributions of DHC common stock, presently estimated to be 87,000 additional shares, is carried at $64,000 in other assets. Had these shares been received at July 4, 2010, the Company would have recorded a $762,000 unrealized holding gain to other comprehensive loss.

(6) Restructuring, Impairments and Other Nonrecurring Charges

As announced during the fourth quarter of 2008, the Company committed to a restructuring program, which included the closure of its Kenton, Ohio facility, significant reductions in the workforce in its Marion, Ohio facility and the integration of its Electronics Group subsidiaries. The purpose of the restructuring program is to reduce fixed costs, accelerate integration efficiencies, exit certain unprofitable product lines and significantly improve operating earnings on a sustained basis. The Company expects to substantially complete its program by the end of 2010. For the three and six months ended July 4, 2010, the Company recorded a restructuring charge of $1,002,000 and $1,415,000, respectively. Of the $1,002,000 recorded in the second quarter, $190,000 was recorded within the Industrial Group and $812,000 was recorded within the Electronics Group. Of these costs, $338,000 was for severance and benefit-related costs, $85,000 related to equipment relocation costs, and $579,000 represented other costs, primarily related to mothball costs associated with closed or partially closed facilities and the consolidation of facilities within the Electronics Group. Of the $1,415,000 recorded in the first half of 2010, $603,000 was recorded within the Industrial Group and $812,000 was recorded within the Electronics Group. Of these costs, $346,000 was for severance and benefit-related costs, $184,000 related to equipment relocation costs, and $885,000 represented other costs, primarily related to mothball costs associated with closed or partially closed facilities and the consolidation of facilities within the Electronics Group. The Company has accrued $2,644,000 related to the restructuring program and expects to incur an additional $1,004,000 in cash expenditures to be paid out during the remainder of 2010 and 2011.

A summary of the pre-tax restructuring charges is as follows (in thousands):

	Total Program	Costs Incurred Six Months Ended July 4, 2010	Total Recognized to date	Remaining Costs to be Recognized
Severance and benefit-related costs	$ 4,046	$ 346	$ 4,046	$ —
Asset impairments	13,517	—	13,517	—
Deferred contract costs write-offs	17,798	—	17,798	—
Inventory related charges	7,895	—	7,895	—
Equipment relocation costs	2,478	184	2,048	430
Asset retirement obligations	1,501	—	1,501	—
Contract termination costs	3,209	—	3,209	—
Other	4,757	885	4,183	574
	$ 55,201	$ 1,415	$ 54,197	$ 1,004

A summary of restructuring activity and related reserves at July 4, 2010 is as follows (in thousands):

	Accrued Balance at December 31, 2009	2010 Charge	Gross Cash Payments	Accrued Balance at July 4, 2010
Severance and benefit-related costs	$ 211	$ 346	$ (135)	$ 422
Asset retirement obligations	1,395	—	(91)	1,304
Contract termination costs	918	—	—	918
Equipment relocation costs	—	184	(184)	—
Other	—	885	(885)	—
	$ 2,524	$ 1,415	$ (1,295)	$ 2,644

A summary of total charges by reportable segment is as follows (in thousands):

	Industrial Group	Electronics Group	Total
Severance and benefit-related costs	$ 2,562	$ 1,484	$ 4,046
Asset impairments	13,517	—	13,517
Deferred contract costs write-offs	—	17,798	17,798
Inventory related charges	—	7,895	7,895
Equipment relocation costs	2,048	—	2,048
Asset retirement obligations	1,501	—	1,501
Contract termination costs	1,868	1,341	3,209
Other	1,050	3,133	4,183
	$ 22,546	$ 31,651	$ 54,197

The total pre-tax costs of $55,201,000 expected to be incurred includes $23,036,000 within the Industrial Group and $32,165,000 within the Electronics Group. The Company expects to incur additional pre-tax costs of $1,004,000, including approximately $490,000 within the Industrial Group and $514,000 within the Electronics Group.

(7) Loss Per Common Share

Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Accordingly, distributed and undistributed earnings attributable to unvested restricted shares (participating securities) have been excluded, as applicable, from net income or loss attributable to common shareholders utilized in the basic and diluted earnings per share calculations.

For the three and six months ended July 4, 2010 and July 5, 2009, diluted weighted average common shares do not include the impact of outstanding stock options and unvested stock-based shares because the effect of these items on diluted net loss would be anti-dilutive.

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

	Three Months Ended		Six Months Ended	
	July 4, 2010	July 5, 2009	July 4, 2010	July 5, 2009
	(Unaudited)		(Unaudited)	
Earnings attributable to stockholders:				
Loss from continuing operations attributable to stockholders	$ (3,964)	$ (6,633)	$ (6,388)	$ (18,166)
Discontinued operations, net of tax	(300)	(145)	(300)	43
Net loss	(4,264)	(6,778)	(6,688)	(18,123)
Less distributed and undistributed earnings allocable to restricted award holders	—	—	—	—
Net loss allocable to common stockholders	$ (4,264)	$ (6,778)	$ (6,688)	$ (18,123)
Basic earnings (loss) per common share attributable to stockholders:				
Continuing operations	$ (0.21)	$ (0.36)	$ (0.34)	$ (0.98)
Discontinued operations	(0.02)	(0.01)	(0.02)	0.00
Net loss	$ (0.23)	$ (0.37)	$ (0.36)	$ (0.98)
Diluted earnings (loss) per common share attributable to stockholders:				
Continuing operations	$ (0.21)	$ (0.36)	$ (0.34)	$ (0.98)
Discontinued operations	(0.02)	(0.01)	(0.02)	0.00
Net loss	$ (0.23)	$ (0.37)	$ (0.36)	$ (0.98)
Weighted average shares outstanding-basic	18,640			