SYPRIS SOLUTIONS INC
Form 10-Q
November 12, 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 September 29, 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**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

101 Bullitt Lane, Suite 450	
Louisville, Kentucky 40222	**(502) 329-2000**
(Address of principal executive offices) (Zip code)	(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. 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 October 25, 2013 the registrant had 20,416,016 shares of common stock outstanding.

Table of Contents

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		**Nine Months Ended**	
	September 29, 2013	**September 30,** 2012	**September 29,** 2013	**September 30,** 2012
	(Unaudited)		**(Unaudited)**	
Net revenue:				
Outsourced services	$ 66,237	$ 66,252	$ 212,693	$ 232,786
Products	10,041	12,511	24,162	41,352
Total net revenue	76,278	78,763	236,855	274,138
Cost of sales:				
Outsourced services	60,589	59,960	193,179	207,702
Products	8,428	9,429	20,003	31,325
Total cost of sales	69,017	69,389	213,182	239,027
Gross profit	7,261	9,374	23,673	35,111
Selling, general and administrative	7,689	7,633	22,445	22,926
Research and development	547	1,084	2,843	2,513
Amortization of intangible assets	0	22	30	66
Impairment of goodwill	0	0	6,900	0
Operating (loss) income	(975)	635	(8,545)	9,606
Interest expense, net	124	98	390	320
(Gain) on sale of marketable securities	0	(1,313)	0	(1,850)
Other expense (income), net	38	561	(1,416)	(1,970)
(Loss) income from continuing operations, before taxes	(1,137)	1,289	(7,519)	13,106
Income tax expense	858	697	2,429	1,989
(Loss) income from continuing operations	(1,995)	592	(9,948)	11,117
Loss from discontinued operations, net of tax	0	(6,331)	0	(7,130)
Net (loss) income	$ (1,995)	$ (5,739)	$ (9,948)	$ 3,987
Basic (loss) income per share:				
(Loss) income per share from continuing operations	$ (0.10)	$ 0.03	$ (0.52)	$ 0.56
Loss per share from discontinued operations	0.00	(0.33)	0.00	(0.37)
Net (loss) income per share	$ (0.10)	$ (0.30)	$ (0.52)	$ 0.19

Diluted (loss) income per share:				
(Loss) income per share from continuing operations	$ (0.10)	$ 0.03	$ (0.52)	$ 0.55
Loss per share from discontinued operations	0.00	(0.32)	0.00	(0.37)
Net (loss) income per share	$ (0.10)	$ (0.29)	$ (0.52)	$ 0.18
Weighted average shares outstanding:				
Basic	19,373	19,074	19,303	19,038
Diluted	19,373	19,567	19,303	19,423
Dividends declared per common share	$ 0.02	$ 0.02	$ 0.06	$ 0.06

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

2

Sypris Solutions, Inc.

Consolidated Statements of Comprehensive Income

(in thousands)

	Three Months Ended		**Nine Months Ended**	
	September 29,	**September 30,**	**September 29,**	**September 30,**
	2013	2012	2013	2012
	(Unaudited)		**(Unaudited)**	
Net (loss) income	$(1,995)	$ (5,739)	$(9,948)	$ 3,987
Other comprehensive income (loss):				
Foreign currency translation adjustments	63	1,904	515	2,551
Reclassification adjustment for net gain on marketable securities included in net income	0	(1,236)	0	(1,685)
Other comprehensive income, net of tax	63	668	515	866
Total comprehensive (loss) income	$(1,932)	$ (5,071)	$(9,433)	$ 4,853

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

Sypris Solutions, Inc.

Consolidated Balance Sheets

(in thousands, except for share data)

	September 29, 2013 **(Unaudited)**	**December 31,** 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 9,613	$ 18,664
Accounts receivable, net	46,454	38,530
Inventory, net	37,600	33,958
Other current assets	4,483	4,946
Total current assets	98,150	96,098
Property, plant and equipment, net	46,138	53,050
Goodwill	0	6,900
Other assets	4,630	4,920
Total assets	$ 148,918	$ 160,968
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 46,001	$ 36,267
Accrued liabilities	23,025	21,988
Total current liabilities	69,026	58,255
Long-term debt	13,026	19,000
Other liabilities	13,698	20,780
Total liabilities	95,750	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; 20,410,940 shares issued and 20,376,575 outstanding in 2013 and 20,190,116 shares issued and 20,155,268 outstanding in 2012	204	202
Additional paid-in capital	150,452	149,576
Retained deficit	(76,440)	(65,282)
Accumulated other comprehensive loss	(21,047)	(21,562)
Treasury stock, 34,365 and 34,848 shares in 2013 and 2012, respectively	(1)	(1)
Total stockholders' equity	53,168	62,933
Total liabilities and stockholders' equity	$ 148,918	$ 160,968

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

Sypris Solutions, Inc.

Consolidated Cash Flow Statements

(in thousands)

	Nine Months Ended September 29, 2013	September 30, 2012
	(Unaudited)	
Cash flows from operating activities:		
Net (loss) income	$(9,948)	$3,987
Loss from discontinued operations	0	(7,130)
(Loss) income from continuing operations	(9,948)	11,117
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	9,355	9,141
Gain on sale of marketable securities	0	(1,850)
Stock-based compensation expense	1,452	1,331
Deferred revenue recognized	(6,000)	(5,919)
Deferred loan costs recognized	58	58
Gain on sale of assets	(1,645)	(2,625)
Provision for excess and obsolete inventory	1,021	629
Goodwill impairment	6,900	0
Other noncash items	549	1,514
Contributions to pension plans	(477)	(1,312)
Change in operating assets and liabilities:		
Accounts receivable	(7,931)	(887)
Inventory	(4,656)	(3,035)
Prepaid expenses and other assets	535	(638)
Accounts payable	9,888	(5,507)
Accrued and other liabilities	31	(930)
Net cash (used in) provided by operating activities	(868)	1,087
Cash flows from investing activities:		
Capital expenditures, net	(3,092)	(4,106)
Proceeds from sale of marketable securities	0	1,271
Proceeds from sale of assets	2,265	4,542
Net cash (used in) provided by investing activities	(827)	1,707
Cash flows from financing activities:		
Net change in debt under revolving credit agreements	(5,974)	(2,000)
Common stock repurchases	(9)	(575)
Indirect repurchase of shares for minimum statutory tax withholdings	(565)	(511)
Cash dividends paid	(808)	(801)
Proceeds from the issuance of common stock	0	1

Net cash used in financing activities	(7,356)	(3,886)
Net decrease in cash and cash equivalents	(9,051)	(1,092)
Cash and cash equivalents at beginning of period	18,664	18,173
Cash and cash equivalents at end of period	$9,613	$ 17,081

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 products and 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 nine months ended September 29, 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, one key customer within the Electronics Group's space business 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 require significant judgment and significantly influence 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 statements 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. (“Sypris Test & Measurement”), 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 2012 to resolve the claim, and the dispute was settled for $6,500,000 during the third quarter of 2012, 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 $581,000 and $1,380,000 during the three and nine months ended September 30, 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 Expense (Income), Net

During the three and nine months ended September 29, 2013, the Company recognized net losses of $37,000 and net gains of $1,645,000, respectively, related to the disposition of idle assets. Additionally, the Company recognized foreign currency translation losses of $69,000 and $455,000 for the three and nine months ended September 29, 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 nine months ended September 30, 2012, the Company recognized net gains of $2,625,000 related to the disposition of idle assets. Additionally, the Company recognized foreign currency related losses of $606,000 and $850,000 for the three and nine months ended September 30, 2012, respectively. These gains and losses are included in other expense (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. The revenues and resulting net income associated with the Company’s continued involvement were deferred and are being recognized over the remaining period of the Company’s supply agreement with Dana, through December 31, 2014. For the nine months ended September 29, 2013 and September 30, 2012, the Company recognized revenue of $6,000,000 and $5,919,000, 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. During 2012, the Company sold all of those shares and recognized a gain of $1,313,000 and $1,850,000 for the three and nine months ended September 30, 2012, respectively.

(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 nine months ended September 29, 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 45,000 and 521,000 potential common shares excluded from diluted earnings per share for the three and nine months ended September 30, 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):

	Three Months Ended		**Nine Months Ended**	
	September 29,	**September 30,**	**September 29,**	**September 30,**
	2013	2012	2013	2012
	(Unaudited)		**(Unaudited)**	
Basic and Diluted Net (Loss) Earnings:				&