

SYPRIS SOLUTIONS INC  
Form 10-Q  
May 02, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington D.C. 20549

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**FORM 10-Q**

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(Mark One)

**Quarterly Report Pursuant To Section 13 Or 15(D) Of The Securities Exchange Act Of 1934**  
For the quarterly period ended April 1, 2007

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

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**SYPRIS SOLUTIONS, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

101 Bullitt Lane, Suite 450

**61-1321992**  
(I.R.S. Employer  
Identification No.)

(502) 329-2000

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**Louisville, Kentucky 40222**  
(Address of principal executive

(Registrant's telephone number,

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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 April 26, 2007, the Registrant had 18,901,875 shares of common stock outstanding.

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**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)**

	<b>Three Months Ended</b>	
	<b>April 1,</b>	<b>March 31,</b>
	<b>2007</b>	<b>2006</b>
	<b>(Unaudited)</b>	
Net revenue:		
Outsourced services	\$ 95,006	\$ 108,812
Products	16,433	21,185
Total net revenue	111,439	129,997
Cost of sales:		
Outsourced services	86,249	101,144
Products	13,183	16,234
Total cost of sales	99,432	117,378
Gross profit	12,007	12,619
Selling, general and administrative	10,902	9,919
Research and development	679	334
Amortization of intangible assets	164	159
Operating income	262	2,207
Interest expense, net	719	1,159
Other income, net	(20)	(250)
(Loss) income before income taxes	(437)	1,298
Income tax (benefit) expense	(192)	441
Net (loss) income	\$ (245)	\$ 857
(Loss) earnings per common share:		
Basic	\$ (0.01)	\$ 0.05
Diluted	\$ (0.01)	\$ 0.05
Dividends declared per common share	\$ 0.03	\$ 0.03
Weighted average shares outstanding:		
Basic	18,107	18,042
Diluted	18,107	18,289

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)

	April 1, 2007 (Unaudited)	December 31, 2006 (Note)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 24,751	\$ 32,400
Restricted cash	1,002	1,002
Accounts receivable, net	60,374	59,876
Inventory, net	82,174	74,146
Other current assets	33,149	34,014
Total current assets	201,450	201,438
Property, plant and equipment, net	149,096	155,341
Goodwill	14,277	14,277
Other assets	7,877	7,977
Total assets	\$ 372,700	\$ 379,033
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 71,824	\$ 76,291
Accrued liabilities	23,957	19,430
Current portion of long-term debt		5,000
Total current liabilities	95,781	100,721
Long-term debt	55,000	55,000
Other liabilities	13,130	13,426
Total liabilities	163,911	169,147
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; 18,901,875 shares issued and 18,898,116 outstanding in 2007 and 18,342,243 shares issued and 18,338,484 outstanding in 2006	189	183
Additional paid-in capital	143,955	143,537
Retained earnings	69,003	69,816
Accumulated other comprehensive loss	(4,342)	(3,634)
Treasury stock, 3,759 shares	(16)	(16)
Total stockholders equity	208,789	209,886

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Total liabilities and stockholders' equity	\$ 372,700	\$ 379,033
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Note: The balance sheet at December 31, 2006 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.

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## SYPRIS SOLUTIONS, INC.

## CONSOLIDATED CASH FLOW STATEMENTS

(in thousands)

	<b>Three Months Ended</b>	
	<b>April 1,</b>	<b>March 31,</b>
	<b>2007</b>	<b>2006</b>
	<b>(Unaudited)</b>	
<b>Cash flows from operating activities:</b>		
Net (loss) income	\$ (245)	\$ 857
<b>Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:</b>		
Depreciation and amortization	7,134	6,819
Noncash compensation expense	207	143
Other noncash items	(356)	(181)
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	(534)	(3,167)
Inventory	(3,900)	938
Other current assets	(3,384)	(236)
Accounts payable	(4,432)	(4,145)
Accrued liabilities	4,685	6,131
<b>Net cash (used in) provided by operating activities</b>	<b>(825)</b>	<b>7,159</b>
<b>Cash flows from investing activities:</b>		
Capital expenditures, net	(697)	(3,862)
Proceeds from sale of assets	22	10
Changes in nonoperating assets and liabilities	(598)	(650)
<b>Net cash used in investing activities</b>	<b>(1,273)</b>	<b>(4,502)</b>
<b>Cash flows from financing activities:</b>		
Net decrease in debt under revolving credit agreements	(5,000)	
Cash dividends paid	(551)	(545)
Proceeds from issuance of common stock		105
Tax benefit of options exercised		35
<b>Net cash used in financing activities</b>	<b>(5,551)</b>	<b>(405)</b>
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(7,649)</b>	<b>2,252</b>
Cash and cash equivalents at beginning of period	32,400	12,060
<b>Cash and cash equivalents at end of period</b>	<b>\$ 24,751</b>	<b>\$ 14,312</b>

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



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**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, testing, and other technical services, typically under multi-year, sole-source contracts with corporations and government agencies in the markets for aerospace & defense electronics, truck components & assemblies, and test & measurement equipment.

**(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 the rules and regulations of the Securities and Exchange Commission. All significant 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 quarterly period ended April 1, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, and notes thereto, for the year ended December 31, 2006 as presented in the Company's Annual Report on Form 10-K.

**(3) Recent Accounting Pronouncements**

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. Specifically, FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of FIN 48 on January 1, 2007. The impact of the Company's tax positions reassessment in accordance with the requirements of FIN 48 was not significant. Additional required disclosures under FIN 48 are included in Note 10 Income Taxes.

**(4) Major Customer Chapter 11 Filing**

On March 3, 2006 (Filing Date), 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. Dana's European, South American, Asia-Pacific, Canadian and Mexican subsidiaries were excluded from the Chapter 11 filing. On May 10, 2006, the Company reached an agreement with Dana (Agreement) under which both parties agreed, among other things, that Dana owed the Company approximately \$22,100,000, subject to reconciliation. Of this amount, the Agreement also provided the Company with a \$9,200,000 progress payment on May 11, 2006, as well as reduced payment terms on a prospective basis. During the third quarter of 2006 and in conjunction with the reconciliation under the Agreement, the Company successfully reconciled approximately \$9,900,000 of payables to Dana against receivables from Dana. As of December 31, 2006, Dana and the Company had substantially completed the reconciliation process under the Agreement. As of April 1, 2007 (excluding certain gain contingencies), net additional accounts receivable expected to be collected from pre-petition Dana (Debtor in Possession) approximated \$1,100,000, although Dana has yet to pay such amounts. The Company also had a \$3,300,000 refundable deposit with Dana at April 1, 2007 for a specified business line yet to be transferred to the Company for which the Company is pursuing reimbursement.

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In addition, on December 6, 2006, an independent arbitrator initially held that Dana had breached certain of its agreements with Sypris by failing to transfer certain volumes of business and by failing to pay the appropriate prices for the volumes that were transferred. As a result, the arbitrator awarded payments to Sypris totaling \$1,818,212 plus \$146,258 per month on an ongoing basis. The arbitration ruling was subject to a 30-day clarification period and was not included in the 2006 consolidated balance sheet. On January 29, 2007, this award became final; and accordingly, net revenue in the consolidated statements of operations for the three months ended April 1, 2007 includes \$2,256,986 pertaining to the arbitration award.

The Company continues to pursue additional offsets, possible gain contingencies, attorneys' fees, interest and other relief through the Bankruptcy Court and other dispute resolution efforts, the outcome of which is uncertain at this time. For the three months ended April 1, 2007, the Company incurred over \$317,000 of legal and other professional fees for Dana related issues. Such costs are included in selling, general and administrative expense in the consolidated statements of operations.

**(5) Stock-Based Compensation**

On January 12, 2007, the Company granted 258,000 restricted stock awards under a key employee retention program which vest over two or four years, as applicable. On March 1, 2007, the Company also granted 305,290 restricted stock awards under a long-term incentive program. Twenty-five percent of the restricted stock awards will vest in one-third increments on each of the third, fifth and seventh anniversaries of the grant date. Seventy-five percent of the restricted stock awards will vest in one-quarter increments on each of the first, second, third and fourth anniversaries of the achievement of the Vesting Trigger Date. This Vesting Trigger Date is the first business day following the Company's achievement of a specified target for aggregate net income as measured over the previous four fiscal quarters. If no Vesting Trigger Date occurs before March 1, 2010, this portion of the restricted stock awards will be immediately forfeited.

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

There were no adjustments required to be made to net (loss) income for purposes of computing basic and diluted (loss) earnings per common share. A reconciliation of the weighted average shares outstanding used in the calculation of basic and diluted (loss) earnings per common share is as follows (in thousands):

	<b>Three Months Ended</b>	
	<b>April 1,</b>	<b>March 31,</b>
	<b>2007</b>	<b>2006</b>
	<b>(Unaudited)</b>	
Shares used to compute basic (loss) earnings per common share	18,107	18,042
Dilutive effect of stock options		247
Shares used to compute diluted (loss) earnings per common share	18,107	18,289

**Table of Contents****(7) Inventory**

Inventory consisted of the following (in thousands):

	April 1, 2007 (Unaudited)	December 31, 2006
Raw materials, including perishable tooling of \$1,561 and \$1,276 in 2007 and 2006, respectively	\$ 25,150	\$ 28,885
Work in process	12,296	12,576
Finished goods	9,479	10,129
Costs relating to long-term contracts and programs, net of amounts attributed to revenue recognized to date	50,197	40,451
Progress payments related to long-term contracts and programs	(8,284)	(11,107)
Reserve for excess and obsolete inventory	(6,664)	(6,788)
	\$ 82,174	\$ 74,146

**(8) Segment Data**

The Company is organized into two business groups, the Industrial Group and the Electronics Group. The Industrial Group is one reportable business segment, while the Electronics Group includes two reportable business segments, Aerospace & Defense and Test & Measurement. 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):

	Three Months Ended April 1, 2007      March 31, 2006 (Unaudited)	
Net revenue from unaffiliated customers:		
Industrial Group	\$ 79,119	\$ 92,499
Aerospace & Defense	19,671	26,011
Test & Measurement	12,649	11,487
Electronics Group	32,320	37,498
	\$ 111,439	\$ 129,997
Gross profit:		
Industrial Group	\$ 5,320	\$ 5,949
Aerospace & Defense	3,155	3,955
Test & Measurement	3,532	2,715
Electronics Group	6,687	6,670
	\$ 12,007	\$ 12,619
Operating income (loss):		
Industrial Group	\$ 2,883	\$ 3,203
Aerospace & Defense	(298)	788

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Test & Measurement	633	206
Electronics Group	335	994
General, corporate and other	(2,956)	(1,990)
	\$ 262	\$ 2,207

**(9) Commitments and Contingencies**

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.

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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.

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, excluding the aforementioned pending major customer bankruptcy proceedings.

As of April 1, 2007, the Company had outstanding purchase commitments of approximately \$35,228,000, primarily for the acquisition of inventory and manufacturing equipment. As of April 1, 2007, the Company also had outstanding letters of credit approximating \$1,726,000 primarily under a captive insurance program.

**(10) Income Taxes**

The Company's effective tax rate for the three months ended April 1, 2007 and March 31, 2006 was 44.0% and 34.0%, respectively. Reconciling items between the federal statutory income tax rate of 34.0% and the effective tax rate include state and foreign income taxes and certain other permanent differences.

Upon the adoption of FIN 48 as of January 1, 2007, the estimated value of the Company's uncertain tax positions approximated \$1,000,000 applicable to unrecognized net tax benefits. If the Company's positions are sustained by the taxing authority in favor of the Company, the entire balance would reduce the Company's effective tax rate. The Company does not expect any reasonably possible material changes to the estimated amount of liability associated with its uncertain tax positions through March 30, 2008. As of April 1, 2007, there have been no significant changes to the liability for uncertain tax positions. The Company recognizes accrued interest and penalties related to uncertain tax positions in income tax expense. As of January 1, 2007, the Company had accrued approximately \$300,000 for the payment of tax-related interest and penalties. The liability for uncertain tax positions including interest and penalties is carried in other liabilities in the consolidated balance sheets.

The Company files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. The Internal Revenue Service (IRS) is not currently examining the Company's U.S. income tax returns for 2003–2007, for which the statute has yet to expire. In addition, open tax years related to state and foreign jurisdictions remain subject to examination but are not considered material.

**(11) Employee Benefit Plans**

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

	<b>Three Months Ended</b>	
	<b>April 1, 2007</b>	<b>March 31, 2006</b>
	<b>(Unaudited)</b>	
Service cost	\$ 28	\$ 24
Interest cost on projected benefit obligation	548	552
Net amortizations, deferrals and other costs	51	134
Expected return on plan assets	(775)	(682)
	<b>\$ (148)</b>	<b>\$ 28</b>

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**(12) Foreign Currency Translation**

The functional currency for the Company's Mexican subsidiary is the Mexican peso. Assets and liabilities are translated at current rates of exchange and income and expense items are translated at the weighted average exchange rate for the period. The resulting translation adjustments are recorded in other comprehensive income (loss) as a separate component of stockholders' equity. Total comprehensive loss for the first quarterly period of 2007 was \$953,000 including foreign currency translation adjustments of \$709,000. Total comprehensive income for the first quarter of 2006 was \$139,000, including foreign currency translation adjustments of \$719,000. For the three months ended April 1, 2007 and March 31, 2006 other income, net includes foreign currency transaction gains of \$15,000 and \$8,000, respectively.

**(13) Subsequent Events**

In April 2007, the Company's Credit Agreement was amended and restated to limit total borrowings at \$50,000,000, with \$50,000,000 of additional borrowings available upon lead bank approval, extend the Credit Agreement through October 2009, revise certain financial covenants providing more flexibility in the Company's financing structure, increase the Company's interest rate structure and add a security interest in the Company's accounts receivable, inventory and equipment. Other terms of the Credit Agreement remain substantially unchanged.

The Company also amended the Senior Notes in April 2007 to enable a portion of their repayment, revise certain financial covenants, modify the June 30, 2014 principal payment to June 30, 2012, increase the Company's fixed interest rates and among other things, add a security interest in the Company's accounts receivable, inventory and equipment. Other terms of the senior notes remained substantially unchanged.

After the aforementioned modifications, the Company's principal commitment under the revolving credit facility is due in 2009, while the Company's principal commitment under the senior notes is \$4,100,000, \$15,000,000 and \$10,900,000 due in 2009, 2011 and 2012, respectively.

In April 2007, the Company borrowed \$19,500,000 and utilized unrestricted cash to ratably repay \$25,000,000 of the outstanding senior notes in addition to paying bank, make whole and attorney fees, and the unpaid interest on the \$25,000,000 of Senior Notes. The majority of the attorney fees were incurred and properly accrued at April 1, 2007.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Results of Operations**

The table presented below, which compares our first quarterly period results of operations from 2007 to 2006, presents the results for each period, the change in those results from 2007 to 2006 in both dollars and percentage change and the results for each period as a percentage of net revenue. The columns present the following:

The first two data columns in the 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 the 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."

**Table of Contents****Three Months Ended April 1, 2007 Compared to Three Months Ended March 31, 2006**

	Three Months Ended,		Year Over	Year Over	Results as Percentage of	
	April 1, 2007	March 31, 2006	Change Favorable (Unfavorable)	Percentage Change Favorable (Unfavorable)	April 1, 2007	March 31, 2006
(in thousands, except percentage data)						
<b>Net revenue:</b>						
Industrial Group	\$ 79,119	\$ 92,499	\$ (13,380)	(14.5)%	71.0%	71.2 %
Aerospace & Defense	19,671	26,011	(6,340)	(24.4)	17.6	20.0
Test & Measurement	12,649	11,487	1,162	10.1	11.4	8.8
Electronics Group	32,320	37,498	(5,178)	(13.8)	29.0	28.8
Total	111,439	129,997	(18,558)	(14.3)	100.0	100.0
<b>Cost of sales:</b>						
Industrial Group	73,799	86,550	12,751	14.7	93.3	93.6
Aerospace & Defense	16,516	22,056	5,540	25.1	84.0	84.8
Test & Measurement	9,117	8,772	(345)	(3.9)	72.1	76.4
Electronics Group	25,633	30,828	5,195	16.9	79.3	82.2
Total	99,432	117,378	17,946	15.3	89.2	90.3
<b>Gross profit:</b>						
Industrial Group	5,320	5,949	(629)	(10.6)	6.7	6.4
Aerospace & Defense	3,155	3,955	(800)	(20.2)	16.0	15.2
Test & Measurement	3,532	2,715	817	30.1	27.9	23.6
Electronics Group	6,687	6,670	17	0.3	20.7	17.8
Total	12,007	12,619	(612)	(4.8)	10.8	9.7
Selling, general and administrative	10,902	9,919	(983)	(9.9)	9.8	7.6
Research and development	679	334	(345)	(103.3)	0.6	0.3
Amortization of intangible assets	164	159	(5)	(3.1)	0.2	0.1
Operating income	262	2,207	(1,945)	(88.1)	0.2	1.7
Interest expense, net	719	1,159	440	38.0	0.6	0.9
Other income, net	(20)	(250)	(230)	(92.0)%	NM	(0.2)
(Loss) income before income taxes	(437)	1,298	(1,735)	NM	(0.4)	1.0
Income tax (benefit) expense	(192)	441	633	NM	(0.2)	0.3
Net (loss) income	\$ (245)	\$ 857	\$ (1,102)	NM	(0.2)%	0.7%

*Backlog.* At April 1, 2007, backlog for our Aerospace & Defense segment increased \$11.6 million to \$102.8 million from \$91.2 million at March 31, 2006, on \$28.3 million in net orders compared to \$19.0 million in net orders in the first three months of 2006. Backlog for our Test & Measurement segment increased \$1.7 million to \$5.7 million at April 1, 2007, on \$12.9 million in net orders compared to \$11.8 million in net orders for the first three months of 2006. We expect to convert approximately 88% of the Aerospace & Defense backlog and 100% of the Test & Measurement backlog at April 1, 2007 to revenue during the next twelve months.



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*Net Revenue.* The Industrial Group primarily derives its revenue from manufacturing services and product sales. Net revenue in the Industrial Group decreased \$13.4 million primarily due to an anticipated \$18.4 million decrease in the heavy truck market, which was partially offset by increased pricing, increased demand from the trailer and energy markets and an arbitration award from a customer.

The Aerospace & Defense segment derives its revenue from product sales and technical outsourced services. Aerospace & Defense segment net revenue decreased \$6.3 million from the prior year quarter. Product sales decreased \$5.4 million primarily related to a \$4.4 million decline related to the delayed launch of two classified programs to replace previous programs. Technical outsourced services decreased \$0.9 million primarily due to the completion of a military program in the prior year.

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The Test & Measurement segment derives its revenue from technical services and product sales. Net revenue from calibration and other outsourced services increased \$1.3 million primarily due to increased demand which was partially offset by decreased product sales of \$0.1 million for the first quarter of 2007 primarily due to volume decreases on a military program.

*Gross Profit.* Our Industrial Group's gross profit of \$5.3 million in the first quarter of 2007 decreased 10.6% from \$5.9 million in the first quarter of 2006 primarily as a result of the anticipated 25% decrease in the heavy truck market, which was largely offset by increased pricing, increased demand from the trailer and energy markets and an arbitration award from a customer which all combined to drive gross profit as a percentage of revenue to 6.7% in the first quarter of 2007 from 6.4% in 2006.

The Aerospace & Defense segment's gross profit decreased \$0.8 million, or 20.2% in the first quarter of 2007 primarily due to decreased revenue of 24.4%, while gross profit as a percentage of revenue increased slightly to 16.0% from 15.2% in the prior year period primarily due to a favorable mix of technical outsourced services programs with higher gross margin rates.

The Test & Measurement segment's gross profit increased \$0.8 million for the first quarter of 2007 primarily due to a favorable shift in the mix of net revenue towards more profitable calibration services revenue, which also led gross profit as a percentage of revenue to increase to 27.9% from 23.6% in the prior year period.

*Selling, General and Administrative.* Selling, general and administrative expense increased \$1.0 million primarily due to the three months ending April 1, 2007 including expenses related to bonus accruals under the 2007 incentive compensation plan and an employee retention program, including non-cash compensation.

*Research and Development.* Research and development costs increased from the prior year quarter primarily due to new product development efforts within our Aerospace & Defense segment.

*Interest Expense, Net.* Interest expense decreased primarily due to decreased weighted average debt outstanding resulting from our working capital management initiative. Our weighted average debt outstanding decreased to \$55.0 million for the first quarter of 2007 from \$76.0 million during the first quarter of 2006. The weighted average interest rate decreased to 5.4% in the first quarter of 2007 from 5.5% in the first quarter of 2006, but is expected to rise in the future as a result of the Company's recently amended Credit Agreement and Senior Notes.

*Income Taxes.* Our effective income tax rate increased to 44.0% in the first quarter of 2007 from 34.0% in the first quarter of 2006, primarily due to the mix of foreign to domestic operating results.

## **Liquidity, Capital Resources and Financial Condition**

Net cash used in operating activities was \$0.8 million in the first quarter of 2007, as compared to net cash provided by operating activities of \$7.2 million in 2006. Net cash used in operating activities includes a net increase in working capital investment as a result of increased inventory and other current assets in preparation for second half of the year 2007 shipments in the Electronics Group. Overall, accounts receivable increased \$0.5 million in the first quarter of 2007 and accounts payable decreased \$4.4 million. Accrued liabilities increased \$4.7 million primarily as a result of the \$5.5 million deferral of an advance customer payment, which was partially offset by lower general accruals as a result of lower volumes. Other current assets increased \$3.4 million primarily as a result of an increase in deferred contract costs.

Net cash used in investing activities decreased \$3.2 million to \$1.3 million in the first quarter of 2007 primarily as a result of decreased capital expenditures.

Net cash used in financing activities was \$5.6 million in the first quarter of 2007, compared to \$0.4 million in the first quarter of 2006 primarily due to the repayment of \$5.0 million on our revolving credit facility in 2007.

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We had no outstanding borrowings under our revolving credit facility at April 1, 2007, and an unrestricted cash balance of \$24.8 million. Approximately \$6.7 million of the unrestricted cash balance relates to our Mexican subsidiaries. In April 2007, our Credit Agreement was amended and restated to limit total borrowings at \$50.0 million, with \$50.0 million of additional borrowings available upon lead bank approval and extend the Credit Agreement through October 2009. We also amended the Senior Notes in April 2007 to enable a portion of their repayment and modify the June 30, 2014 principal payment to June 30, 2012. The amendments for the Senior Notes and Credit Agreement also increase our interest rates, revise certain financial covenants providing more flexibility in our financing structure and add a security interest in our accounts receivable, inventory and equipment. Other terms of the Credit Agreement and Senior Notes remain substantially unchanged.

In April 2007, the Company borrowed \$19.5 million and utilized unrestricted cash to ratably repay \$25.0 million of the outstanding Senior Notes in addition to paying bank and attorney fees and the unpaid interest, as applicable. After the aforementioned modifications, our principal commitment under the revolving credit facility is due in 2009, while our principal commitment under the senior notes is \$4.1 million, \$15.0 million and \$10.9 million due in 2009, 2011 and 2012, respectively. We also had purchase commitments totaling approximately \$35.2 million at April 1, 2007, primarily for inventory and manufacturing equipment.

We believe that sufficient resources will be available to satisfy our cash requirements for at least the next twelve months. Cash requirements for periods beyond the next twelve months depend on our profitability, our ability to manage working capital requirements and our rate of growth. If we make significant acquisitions, if working capital and capital expenditure requirements exceed expected levels during the next twelve months or in subsequent periods or if Dana is unable to successfully reorganize, we may require additional external sources of capital. There can be no assurance that any additional required financing will be available through bank borrowings, debt or equity financings or otherwise, or that if such financing is available, it will be available on terms acceptable to us. If adequate funds are not available on acceptable terms, our business, results of operations and financial condition could be adversely affected.

### **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 Operation Critical Accounting Policies in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006. There have been no significant changes in our critical accounting policies during the first quarter of 2007, except for the treatment of tax contingency accruals.

Effective January 1, 2007, the Company began to measure and record tax contingency accruals in accordance with FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109. The expanded disclosure requirements of FIN 48 are presented in Note 10 to the Consolidated Financial Statements in Part I, Item I.

FIN 48 prescribes a threshold for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Only tax positions meeting the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption. FIN 48 also provides guidance on accounting for derecognition, interest and penalties, and classification and disclosure of matters related to uncertainty in income taxes. Adjustments to other tax accruals are generally recorded in earnings in the period they are determined. Prior to January 1, 2007, the Company recorded accruals for tax contingencies and related interest when it was probable that a liability had been incurred and the amount of the contingency could be reasonably estimated.

### **Forward-looking Statements**

This quarterly report, and our other oral or written communications, may 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 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 you should not place undue reliance on these forward-looking statements.

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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 include: cost and availability of raw materials such as steel, components, freight, natural gas or utilities; cost and inefficiencies associated with increasing our manufacturing capacity and launching new programs; stability and predictability of our costs and margins or our customers' forecasts, financial conditions (including bankruptcies or other restructurings), late payments, low-margin product mix, market shares, changing product requirements or scheduling demands; costs associated with breakdowns or repairs of machinery and equipment; growth beyond our productive capacity, cyclical or other downturns, adverse impacts of new technologies or other competitive pressures which erode our margins; cost, efficiency and yield of our operations including capital investments, working capital, scrap rates, cycle times, injuries, self-insured risks, wages, freight, production schedules, overtime costs, expediting costs or scrap rates; failure to make strategic acquisitions or to integrate and improve results of acquired businesses or to identify and adequately insure environmental or other risks in due diligence; inventory valuation risks due to obsolescence, shrinkage, price, overstocking or underbilling; changes in government funded or other customer programs (including the failure to appropriate funds for IDIQ contracts); reliance on major customers or suppliers; revised contract prices or estimates of major contract costs; dependence on, recruitment or retention of management or other key employees; union negotiations; pension valuation, health care or other benefit costs; labor relations; strikes; risks of foreign operations; currency exchange rates; costs and supply of debt, equity capital, or insurance due to poor operating or financial results, new business risks, credit ratings, debt covenants (including those regarding our creditors' secured interests), contract claims, insurance conditions or regulatory developments; impairments or write-offs of goodwill or fixed assets; changes in licenses, security clearances, or other legal rights to operate, manage our work force or import and export as needed; completion of the internal control assessment process; costs of compliance with auditing, regulatory or contractual obligations; regulatory actions or sanctions; contract terminations or other disputes or litigation, involving customer, supplier, creditor, stockholder, product liability, environmental or asbestos-related claims; 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, 2006.

In this quarterly report, we may rely on and refer to information and statistics regarding the markets in which we compete. We obtained this information and these statistics from various third party sources and publications that are not produced for the purposes of securities offerings or reporting or economic analysis. We have not independently verified the data and cannot assure you of the accuracy of the data we have included.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to financial market risks, including changes in interest rates and foreign currency exchange rates. All additional borrowings under our credit agreement bear interest at a variable rate based on the prime rate, the London Interbank Offered Rate ( LIBOR ), or certain alternative short-term rates, plus a margin (1.00% at April 1, 2007) based upon our leverage ratio. A change in interest rates of 100 basis points would not significantly change interest expense on an annualized basis, based upon our debt outstanding at April 1, 2007. A change in fixed interest rates of 100 basis points would change the fair value of our Senior Notes by \$2.4 million. Fluctuations in foreign currency exchange rates have historically impacted our earnings only to the extent of remeasurement gains related to U.S. Dollar denominated accounts of our foreign subsidiary, because the vast majority of our transactions are denominated in U.S. Dollars. A one percent change in foreign currency exchange rates would result in remeasurement gain or loss of approximately \$0.3 million on an annualized basis, based upon the U.S. Dollar denominated accounts of our foreign subsidiary at April 1, 2007. Inflation has not been a significant factor in our operations in any of the periods presented; however, there can be no assurances that the costs of steel will not adversely affect our working capital requirements and our associated interest costs, which could also increase the sensitivity of our results to changes in interest rates.

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**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**

None.

**ITEM 1A. RISK FACTORS**

Information regarding risk factors appears in MD&A Forward-Looking Statements, in Part I Item 2 of this Form 10-Q and in Part I Item 1A of our Report on Form 10-K for the fiscal year ended December 31, 2006.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**ITEM 5. OTHER INFORMATION**

None.

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**ITEM 6. EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
10.1	Amended and Restated Loan Agreement dated as of April 6, 2007 between Sypris Solutions, Inc., Sypris Test & Measurement, Inc., Sypris Technologies, Inc., Sypris Electronics, LLC, Sypris Data Systems, Inc., Sypris Technologies Marion, LLC, Sypris Technologies Kenton, Inc., Sypris Technologies Mexican Holdings, LLC; and JP Morgan Chase Bank, N.A., LaSalle Bank National Association, and National City Bank. (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on April 11, 2007 (Commission File No. 000-24020))
10.2	Third Amendment to the Note Purchase Agreement dated as of April 6, 2007 between Sypris Solutions, Inc., Sypris Test & Measurement, Inc., Sypris Technologies, Inc., Sypris Electronics, LLC, Sypris Data Systems, Inc., Sypris Technologies Marion, LLC, Sypris Technologies Kenton, Inc., Sypris Technologies Mexican Holdings, LLC; and The Guardian Life Insurance Company Of America, Connecticut General Life Insurance Company, Life Insurance Company of North America, Jefferson Pilot Financial Insurance Company, Lincoln National Life Insurance Company, Lincoln Life & Annuity Company of New York. (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed on April 11, 2007 (Commission File No. 000-24020))
10.3	Security Interest Agreement dated April 6, 2007 (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K filed on April 11, 2007 (Commission File No. 000-24020)).
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.
32	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.

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**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: May 2, 2007

By:

/s/ T. Scott Hatton  
(T. Scott Hatton)

Vice President & Chief Financial Officer

Date: May 2, 2007

By:

/s/ Jeffrey T. Reibel  
(Jeffrey T. Reibel)

Controller (Principal Accounting Officer)