SYPRIS SOLUTIONS INC
Form 10-Q
May 06, 2014

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 March 30, 2014

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 May 2, 2014, the Registrant had 20,520,902 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	
	March 30, 2014	**March 31, 2013**
	(Unaudited)	
Net revenue:		
Outsourced services	$76,520	$72,083
Products	7,724	6,328
Total net revenue	84,244	78,411
Cost of sales:		
Outsourced services	67,981	65,210
Products	5,699	5,125
Total cost of sales	73,680	70,335
Gross profit	10,564	8,076
Selling, general and administrative	7,992	7,158
Research and development	151	877
Amortization of intangible assets	0	22
Impairment of goodwill	0	6,900
Operating income (loss)	2,421	(6,881)
Interest expense, net	132	146
Other (income), net	(528)	(1,195)
Income (loss), before taxes	2,817	(5,832)
Income tax expense	1,165	627
Net income (loss)	$1,652	$(6,459)
Income (loss) per share:		
Basic	$0.08	$(0.34)
Diluted	$0.08	$(0.34)
Weighted average shares outstanding:		
Basic	19,417	19,151
Diluted	19,446	19,151
Dividends declared per common share	$0.02	$0.02

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

Sypris Solutions, Inc.

Consolidated Statements of Comprehensive Income

(in thousands)

	Three Months Ended	
	March 30, 2014	March 31, 2013
	(Unaudited)	
Net income (loss)	$1,652	$(6,459)
Other comprehensive income:		
Foreign currency translation adjustments, net of tax	26	1,716
Comprehensive income (loss)	$1,678	$(4,743)

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

Sypris Solutions, Inc.

Consolidated Balance Sheets

(in thousands, except for share data)

	March 30, 2014 (Unaudited)	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 19,065	$ 18,674
Accounts receivable, net	58,468	38,533
Inventory, net	36,565	34,422
Other current assets	3,747	5,403
Total current assets	117,845	97,032
Property, plant and equipment, net	42,426	44,683
Other assets	4,542	4,568
Total assets	$ 164,813	$ 146,283
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 54,582	$ 36,684
Accrued liabilities	24,226	23,806
Total current liabilities	78,808	60,490
Long-term debt	23,000	24,000
Other liabilities	5,212	5,541
Total liabilities	107,020	90,031
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; 20,405,503 shares issued and 20,282,349 outstanding in 2014 and 20,448,007 shares issued and 20,399,649 outstanding in 2013	204	204
Additional paid-in capital	150,827	150,569
Retained deficit	(75,529)	(76,786)
Accumulated other comprehensive loss	(17,708)	(17,734)
Treasury stock, 123,154 and 48,358 shares in 2014 and 2013, respectively	(1)	(1)
Total stockholders' equity	57,793	56,252
Total liabilities and stockholders' equity	$ 164,813	$ 146,283

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

Sypris Solutions, Inc.

Consolidated Cash Flow Statements

(in thousands)

	Three Months Ended March 30, 2014	March 31, 2013
	(Unaudited)	
Cash flows from operating activities:		
Net income (loss)	$1,652	$(6,459)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,714	3,073
Stock-based compensation expense	405	388
Deferred revenue recognized	(2,164)	(2,000)
Deferred loan costs recognized	19	19
Gain on sale of assets	(4)	(1,665)
Provision for excess and obsolete inventory	103	280
Goodwill impairment	0	6,900
Other noncash items	117	812
Contributions to pension plans	(199)	(11)
Changes in operating assets and liabilities:		
Accounts receivable	(19,953)	(14,344)
Inventory	(2,247)	(2,799)
Other current assets	1,662	202
Accounts payable	17,925	17,545
Accrued and other liabilities	2,469	(1,362)
Net cash provided by operating activities	2,499	579
Cash flows from investing activities:		
Capital expenditures, net	(559)	(945)
Proceeds from sale of assets	8	2,141
Net cash (used in) provided by investing activities	(551)	1,196
Cash flows from financing activities:		
Net change in debt under revolving credit agreements	(1,000)	(1,500)
Common stock repurchases	(116)	0
Indirect repurchase of shares of minimum statutory tax withholdings	(33)	(451)
Cash dividends paid	(408)	0
Net cash used in financing activities	(1,557)	(1,951)
Net increase (decrease) in cash and cash equivalents	391	(176)
Cash and cash equivalents at beginning of period	18,674	18,664
Cash and cash equivalents at end of period	$19,065	$18,488

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 (see Note 11, “Segment Data,” to the consolidated financial statements).

(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 United Kingdom (“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 months ended March 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, and notes thereto, for the year ended December 31, 2013 as presented in the Company’s Annual Report on Form 10-K.

(3) Customer Contract Negotiations

Our supply agreement with Dana Holding Corporation (“Dana”) expires on December 31, 2014 and our supply agreements with Meritor, Inc. (Meritor) expire on December 31, 2014 and May 2, 2015. For the three months ended March 30, 2014, Dana and Meritor represented approximately 59% and 16%, of our net revenue, respectively.

Sypris and Dana have signed an amended and restated supply agreement, the binding effect of which is currently in dispute. Dana has repudiated this agreement and purported to exercise its rights under the prior agreement to begin exploring alternative supply relationships with third parties, including the right to sign new supply agreements, authorize tooling expenditures and engage in certain production part approval processes (PPAP) with respect to the goods currently supplied by Sypris. Sypris disputes Dana's ability to exercise such rights. In addition, Dana has notified us that it intends to terminate its supply relationship with us effective December 31, 2014 and to transition over 2,000 active part numbers, which we currently manufacture for Dana, to alternative suppliers at the expiration date of the original supply agreement. The failure to resolve this dispute with Dana on acceptable terms would have a material adverse effect on our financial condition and financial performance, and there can be no assurances whether or not Dana will be held liable for adequate monetary damages as a result.

In addition, the failure to enter into an agreement with Meritor on acceptable terms, or the entry into agreements for fewer products or reduced volumes or prices would have a material adverse effect on our financial condition and financial performance.

The Company is exploring alternatives to address the various range of outcomes for both the Dana and Meritor supply agreements, including the complete or partial renewal of either or both supply agreements, pursuing new business opportunities with existing and potential customers, identifying alternative uses for the assets and certain other contingency plans. The Company expects to have plans established and executed prior to December 31, 2014 to support its operations and provide sufficient liquidity to finance its operations for 2014 and the foreseeable future.

(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. 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 of 2013, 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. Further, the Company experienced a decline in the market value of its equity subsequent to March 31, 2013.

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 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) Milestone Revenue Recognition

The Company periodically enters into research and development contracts with customers related primarily to key encryption products. When the contracts provide for milestone or other interim payments, the Company will recognize revenue under the milestone method in accordance with ASC 605-28. The Company had one contract in process as of March 30, 2014 being accounted for under the milestone method. The milestone method requires the Company to deem all milestone payments within each contract as either substantive or non-substantive. That conclusion is determined based upon a thorough review of each contract and the deliverables to which the Company has committed in each contract. For substantive milestones, the Company concludes that upon achievement of each milestone, the amount of the corresponding defined payment is commensurate with the effort required to achieve such milestone or the value of the delivered item. The payment associated with each milestone relates solely to past performance and is deemed reasonable upon consideration of the deliverables and the payment terms within the contract. Milestones may include, for example, the successful completion of design review or technical review, the submission and acceptance of technical drawings, delivery of hardware, software or regulatory agency certifications. All milestones under the contract in process as of March 30, 2014 were deemed substantive. During the first quarter ended March 30, 2014, revenue recognized through the achievement of multiple milestones amounted to $1,275,000. There are no performance, cancellation, termination or refund provisions in the arrangement that contain material financial consequences to the Company.

(6) Dana Claim

On March 3, 2006, 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 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 three months ended March 30, 2014 and March 31, 2013, the Company recognized into revenue $2,164,000 and $2,000,000, respectively, related to the Claim.

(7) Other (Income), Net

During the three months ended March 30, 2014, the Company recognized net gains of $591,000 within the Industrial Group from the receipt of federal grant funds for improvements made under a flood relief program. Additionally, the Company recognized foreign currency related losses of $31,000 related to the U.S. dollar denominated monetary asset position of our Mexican subsidiaries for which the Mexican peso is the functional currency. For the three months ended March 31, 2013, the Company recognized net gains of $1,665,000 related to the sale of idle assets. Additionally, the Company recognized foreign currency related losses of $573,000 for the three months ended March 31, 2013. These gains and losses are included in other (income), net on the consolidated statements of operations.

(8) Earnings (Loss) 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. There were 858,000 potential common shares excluded from diluted earnings per share for the three months ended March 30, 2014. For the three months ended March 31, 2013, diluted weighted average common shares do not include the impact of any outstanding stock options and unvested compensation-related 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 earnings (loss) per common share is as follows (in thousands):

	Three Months Ended	
	March 30, 2014	**March 31, 2013**
	(Unaudited)	
Income (loss) attributable to stockholders:		

Income (loss) from continuing operations as reported	$1,652	$(6,459)
Less distributed and undistributed earnings allocable to restricted awarded holders	(54)	0
Less dividends declared attributed to restricted awarded holders	(14)	(12)
Net income (loss) allocable to common stockholders	$1,584	$(6,471)
Income (loss) per common share attributable to stockholders:		
Basic	$0.08	$(0.34)
Diluted	$0.08	$(0.34)
Weighted average shares outstanding – basic	19,417	19,151
Weighted average additional shares assuming conversion of potential common shares	29	0
Weighted average shares outstanding – diluted	19,446	19,151

(9) Inventory

Inventory consisted of the following (in thousands):

	March 30, 2014 (Unaudited)	December 31, 2013
Raw materials	$ 20,542	$ 19,372
Work in process	17,382	16,436
Finished goods	5,104	5,017
Reserve for excess and obsolete inventory	(6,463)	(6,403)
	$ 36,565	$ 34,422

(10) Property, Plant and Equipment

Property, plant and equipment consists of the following (in thousands):

	March 30, 2014 (Unaudited)	December 31, 2013
Land and land improvements	$ 2,998	$ 2,999
Buildings and building improvements	26,051	26,053
Machinery, equipment, furniture and fixtures	161,427	161,207
Construction in progress	2,386	2,133
	192,862	192,392
Accumulated depreciation	(150,436)	(147,709)
	$ 42,426	$ 44,683

The Industrial Group performed an asset recoverability test for one of its asset groups totaling approximately $38,403,000 as of March 30, 2014. The Company concluded that the undiscounted sum of estimated future cash flows exceeded the carrying value for such asset group, and accordingly, no impairment was recognized.

(11) 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 the 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):

	Three Months Ended March 30, 2014	**March 31, 2013**
	(Unaudited)	
Net revenue from unaffiliated customers:		
Industrial Group	$75,839	$71,149
Electronics Group	8,405	7,262
	$84,244	$78,411
Gross profit (loss):		
Industrial Group	$11,154	$8,110
Electronics Group	(590)	(34)
	$10,564	$8,076
Operating income (loss):		
Industrial Group	$8,113	$5,385
Electronics Group	(3,077)	(10,151)
General, corporate and other	(2,615)	(2,115)
	$2,421	$(6,881)

	March 30, 2014	**December 31, 2013**
	(Unaudited)	
Total assets:		
Industrial Group	$120,165	$100,593
Electronics Group	30,579	29,689
General corporate and other	14,069	16,001
	$164,813	$146,283

(12) 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 March 30, 2014 and December 31, 2013 was $1,358,000 and $1,439,000, respectively. The Company’s warranty expense for the three months ended March 30, 2014 and March 31, 2013 was $67,000 and $65,000, respectively.

Additionally, the Company sells three and five-year extended warranties for certain link encryption products. The revenue from the extended warranties is deferred and recognized ratably over the contractual term. As of March 30, 2014 and December 31, 2013, the Company had deferred revenue of $1,288,000 and $1,567,000, 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.

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 March 30, 2014, the Company had outstanding purchase commitments of approximately $8,689,000, primarily for the acquisition of inventory and manufacturing equipment. As of March 30, 2014, the Company also had outstanding letters of credit approximating $806,000 primarily under the aforementioned captive insurance program.

(13) Income Taxes

The provision for income taxes includes federal, state, local and foreign taxes. The Company's effec