SYPRIS SOLUTIONS INC
Form 10-Q
November 05, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934**
For the quarterly period ended September 28, 2008

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	**(I.R.S. Employer**
of incorporation or organization)	**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. x 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. (Check one):

Large accelerated filer	¨	Accelerated filer	x
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 x No

As of October 24, 2008, the Registrant had 19,298,003 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 September 28, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 28, 2008	Nine Months Ended September 30, 2007
	(Unaudited)		(Unaudited)	
Net revenue:				
Outsourced services	$ 80,145	$ 86,897	$ 258,381	$ 273,241
Products	20,012	17,623	58,388	58,965
Total net revenue	100,157	104,520	316,769	332,206
Cost of sales:				
Outsourced services	77,607	80,182	238,755	253,587
Products	15,895	13,866	47,556	48,439
Total cost of sales	93,502	94,048	286,311	302,026
Gross profit	6,655	10,472	30,458	30,180
Selling, general and administrative	10,431	10,369	31,485	29,740
Research and development	938	608	3,022	2,001
Amortization of intangible assets	42	129	171	457
Nonrecurring items	655	(4,835)	655	(3,281)
Operating (loss) income	(5,411)	4,201	(4,875)	1,263
Interest expense, net	1,093	991	3,068	2,624
Other expense (income), net	1,050	(26)	134	15
(Loss) income before income taxes	(7,554)	3,236	(8,077)	(1,376)
Income tax expense (benefit)	202	599	229	(1,467)
Net (loss) income	$ (7,756)	$ 2,637	$ (8,306)	$ 91
(Loss) earnings per common share:				
Basic	$ (0.42)	$ 0.14	$ (0.45)	$ 0.00
Diluted	$ (0.42)	$ 0.14	$ (0.45)	$ 0.00
Dividends declared per common share	$ 0.03	$ 0.03	$ 0.09	$ 0.09
Weighted average shares outstanding:				
Basic	18,369	18,314	18,354	18,196
Diluted	18,369	18,548	18,354	18,351

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)

	September 28, 2008 (Unaudited)	December 31, 2007 (Note)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,552	$ 14,622
Restricted cash	626	883
Accounts receivable, net	56,699	59,067
Inventory, net	68,587	71,789
Other current assets	34,768	107,132
Total current assets	175,232	253,493
Investment in marketable securities	18,164	
Property, plant and equipment, net	126,130	137,104
Goodwill	14,277	14,277
Other assets	25,259	17,186
Total assets	$ 359,062	$ 422,060
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 61,823	$ 54,119
Accrued liabilities	25,134	41,933
Current portion of long-term debt	4,091	5,000
Total current liabilities	91,048	101,052
Long-term debt	60,909	60,000
Other liabilities	46,949	53,529
Total liabilities	198,906	214,581
Stockholders equity:		
Preferred stock, par value $0.01 per share, 975,150 shares authorized; no shares issued		
Series A preferred stock, par value $0.01 per share, 24,850 shares authorized; no shares issued		
Common stock, non-voting, par value $0.01 per share, 10,000,000 shares authorized; no shares issued		
Common stock, par value $0.01 per share, 30,000,000 shares authorized; 19,496,620 shares issued and 19,277,645 shares outstanding in 2008 and 19,205,247 shares issued and 19,078,440 shares outstanding in 2007	195	192
Additional paid-in capital	146,709	146,025
Retained earnings	55,385	65,402
Accumulated other comprehensive loss	(42,131)	(3,943)
Treasury stock, 218,975 and 126,807 shares in 2008 and 2007, respectively	(2)	(197)
Total stockholders equity	160,156	207,479
Total liabilities and stockholders equity	$ 359,062	$ 422,060

Note: The balance sheet at December 31, 2007 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)

	Nine Months Ended September 28, 2008	Nine Months Ended September 30, 2007
	(Unaudited)	
Cash flows from operating activities:		
Net (loss) income	$ (8,306)	$ 91
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation and amortization	19,621	21,738
Noncash compensation expense	901	1,276
Other noncash items	(7,888)	(23,359)
Change in operating assets and liabilities:		
Accounts receivable	2,910	(5,377)
Inventory	1,916	(3,916)
Other current assets	6,230	(3,414)
Accounts payable	8,066	(3,221)
Accrued liabilities	(13,351)	12,897
Net cash provided by (used in) operating activities	10,099	(3,285)
Cash flows from investing activities:		
Capital expenditures, net	(9,484)	(5,118)
Proceeds from sale of assets	998	22
Changes in nonoperating assets and liabilities	51	(267)
Net cash used in investing activities	(8,435)	(5,363)
Cash flows from financing activities:		
Net change in debt under revolving credit agreements		20,000
Payments on Senior Notes		(25,000)
Debt modification costs		(885)
Cash dividends paid	(1,734)	(1,690)
Proceeds from issuance of common stock		168
Net cash used in financing activities	(1,734)	(7,407)
Net decrease in cash and cash equivalents	(70)	(16,055)
Cash and cash equivalents at beginning of period	14,622	32,400
Cash and cash equivalents at end of period	$ 14,552	$ 16,345

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 truck components & assemblies, aerospace & defense electronics, 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 three and nine months ended September 28, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, and notes thereto, for the year ended December 31, 2007 as presented in the Company s Annual Report on Form 10-K.

Certain prior period amounts have been reclassified to conform to the current period presentation.

(3) Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, *Fair Value Measurements*. The objective of SFAS No. 157 is to increase consistency and comparability in fair value measurements and to expand disclosures about fair value measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS No. 157 was effective for the Company on January 1, 2008. However, in February 2008, the FASB released FASB Staff Position (FSP) SFAS No. 157-2, *Effective Date of FASB Statement No. 157*, which delayed the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The adoption of SFAS No. 157 for financial assets and liabilities did not have a material impact on the Company s consolidated financial statements. The adoption of SFAS No. 157 for non-financial assets and liabilities, effective January 1, 2009, is not expected to have a significant impact on the Company s consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment to ARB No. 51* (SFAS No. 160). SFAS No. 160 requires all entities to report noncontrolling interests in subsidiaries as equity in the consolidated financial statements, but separate from the equity of the parent company. The statement further requires that consolidated net income be reported at amounts attributable to the parent and the noncontrolling interest, rather than expensing the income attributable to the minority interest holder. This statement also requires that companies provide sufficient disclosures to clearly identify and distinguish between the interests of the parent company and the interests of the noncontrolling owners, including a disclosure on the face of the consolidated statements for income attributable to the noncontrolling interest holder. This statement is effective for fiscal years beginning on or after December 15, 2008. Early adoption is prohibited. The adoption of this statement is not expected to have a significant impact on the Company s consolidated financial statements.

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In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* (SFAS No. 161). SFAS No. 161 applies to all derivative instruments and nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 37 and 42 of Statement 133, and related hedged items accounted for under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133). SFAS No. 161 requires entities to provide greater transparency through additional disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, results of operations, and cash flows. This statement is effective for fiscal years beginning on or after November 15, 2008. Early adoption is encouraged. The adoption of this statement is not expected to have a significant impact on the Company s disclosures included in its consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position SFAS 142-3, *Determination of the Useful Life of Intangible Assets*, (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of FSP 142-3 on its consolidated financial position and results of operations.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. This statement is not expected to change existing practices but rather reduce the complexity of financial reporting. This statement will go into effect 60 days after the SEC approves related auditing rules.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. This FSP addresses whether instruments granted in share-based payment transactions may be participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing basic earnings per share (EPS) pursuant to the two-class method described in paragraphs 60 and 61 of SFAS No. 128, *Earnings Per Share*. A share-based payment award that contains a non-forfeitable right to receive cash when dividends are paid to common shareholders irrespective of whether that award ultimately vests or remains unvested shall be considered a participating security as these rights to dividends provide a non-contingent transfer of value to the holder of the share-based payment award. Accordingly, these awards should be included in the computation of basic EPS pursuant to the two-class method. The guidance in this FSP is effective for fiscal years beginning after December 15, 2008 and interim periods within those years. Early adoption is not permitted. All prior period EPS data will be adjusted retrospectively to reflect the provisions of the FSP. Under the terms of the Company s restricted stock awards, grantees are entitled to receive dividends on the unvested portions of their awards. There is no requirement to return these dividends in the event the unvested awards are forfeited in the future. Accordingly, this FSP will have an effect on the Company s EPS calculations and the Company will continue to evaluate the effects of this guidance.

(4) Dana Claim

On March 3, 2006, the Company s largest customer, 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 July 24, 2007, the Company announced that its wholly-owned subsidiary, Sypris Technologies, Inc., entered into a comprehensive settlement agreement with Dana to resolve all outstanding disputes between the parties, terminate previously approved arbitration payments and enter into a new long-term supply contract running through 2014. In addition, Dana provided the Company with an allowed general unsecured non-priority claim in the amount of $89,900,000, which was recorded by the Company at its estimated fair value of $76,483,000 as of the August 7, 2007 settlement date.

On December 12, 2007 the bankruptcy court approved Dana s plan of reorganization. Pursuant to the terms included therein, the Company became entitled to receive an initial distribution of 3,090,408 shares of common stock in Dana Holding Corporation (DAN), the right to participate in additional distributions of reserved

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shares of common stock of DAN if certain disputed matters are ultimately resolved for less than Dana s reserves for those matters (estimated by the Company to represent an additional 739,000 shares) and the right to receive a distribution of cash. Dana emerged from bankruptcy on January 31, 2008, and on February 1, 2008, the newly issued shares of Dana Holding Corporation began trading on the New York Stock Exchange. On February 11, 2008, the Company received its initial distribution of common stock, and on March 18, 2008 the Company received its cash distribution totaling $6,891,188. On April 21, 2008 and July 30, 2008, the Company received 114,536 and 152,506 of DAN common shares, respectively, representing approximately 36% of the total 739,000 additional common shares the Company expects to receive.

The aforementioned cash distribution was recorded as a reduction in the Company s $76,483,000 recorded basis in the claim. Of the remaining $69,592,000, $56,162,000 was attributed to the initial distribution of shares received by the Company in February, 2008, $2,081,000 was attributed to the shares received by the Company in April, 2008, and $2,771,000 was attributed to the shares received by the Company in July, 2008. The remaining $8,578,000 is attributed to the 472,000 of additional shares expected to be received by the Company as additional distributions. If the Company ultimately receives fewer additional shares than expected, these allocations would be adjusted on a pro rata basis.

The Company accounts for its common stock in DAN in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS No. 115). The Company accounts for its shares as available-for-sale securities with associated unrealized holding gains or losses reported as a component of other comprehensive loss or income. The Company has not sold any of its common stock in DAN, and at September 28, 2008, the basis and fair value of the Company s holdings of DAN common stock amounted to $61,015,000 and $18,164,000, respectively. Unrealized holding losses recorded in other comprehensive loss totaled $38,673,000, net of income taxes of $4,178,000. See Note 6 for further information.

The Company believes that the price for Dana s common stock at September 28, 2008 is temporarily depressed. A number of market issues including sub-prime lending practices, tightening credit markets and recession concerns have driven market prices down. A substantial portion of the owners of DAN stock were contractually restricted from trading those shares through July of 2008, while many equity mutual funds remained restricted from purchasing stock in businesses that have recently emerged from bankruptcy. The automotive sector has been under considerable scrutiny due to bankruptcies, sharply declining light vehicle sales and significant losses recorded by major companies within the sector. At September 28, 2008, the Company believed that these negative factors were likely to begin to improve in the near term and that it possessed the ability and intent to hold its shares of Dana common stock until a full recovery of the current carrying value occurs. However, there can be no assurance that, under applicable accounting principles, unrealized holding losses will not be deemed other-than-temporary and be recognized through the Company s statement of operations in future periods, which could materially adversely affect the Company s business, results of operations and financial condition.

At September 28, 2008, the Company s right to participate in additional distributions of DAN common stock, presently estimated to be 472,000 additional shares, was carried at $8,578,000 in other assets. Had these shares been received at September 28, 2008, the Company would have recorded an additional $5,101,000 unrealized holding loss to other comprehensive loss, net of income taxes of $923,000. See Note 14 for further information.

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(5) (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):

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
	(Unaudited)		(Unaudited)	
Shares used to compute basic (loss) earnings per common share	18,369	18,314	18,354	18,196
Dilutive effect of equity awards		234		155
Shares used to compute diluted (loss) earnings per common share	18,369	18,548	18,354	18,351

(6) Investment in Marketable Securities

The valuation of our investment in DAN, a marketable security accounted for pursuant to SFAS No. 115, is classified as available-for-sale and measured at fair value as determined by a quoted market price. The related unrealized holding losses are currently excluded from operations and recorded in accumulated other comprehensive loss on the consolidated balance sheets. At September 28, 2008, the Company owned 3,357,450 shares of DAN with a market value of $5.41 per share, which resulted in an unrealized loss of $38,673,000, net of a deferred tax benefit of $4,178,000, included in accumulated other comprehensive loss as of such date. The deferred tax benefit is net of a valuation allowance of $2,387,000 associated with the unrealized capital loss portion for our foreign subsidiary, as the Company has no assurance of generating capital gains in the future in order to realize the tax benefit. The deferred tax benefit associated with the unrealized loss for our domestic operations has been fully reserved. At September 28, 2008, this decline was considered by the Company to be temporary (see Note 4). Realized gains and losses and declines in value judged to be other-than-temporary will be included in other expense (income), if and when recorded. In accordance with SFAS No. 157, the fair value of DAN shares was valued based on quoted market prices in active markets for identical shares.

The following table summarizes marketable securities as of September 28, 2008 (in thousands):

	Basis	Gross Unrealized Gain/(Loss)	Gross Realized Gain/(Loss)	Fair Value At Quoted Prices in Active Markets (Level 1)
Investment in marketable securities	$ 61,015	$ (42,851)	$	$ 18,164

(7) Inventory

Inventory consisted of the following (in thousands):

	September 28, 2008	December 31, 2007
	(Unaudited)	
Raw materials, including perishable tooling of $896 and $1,129 in 2008 and 2007, respectively	$ 19,201	$ 21,140
Work in process	12,380	12,815

Finished goods	7,076	7,439
Costs relating to long-term contracts and programs, net of amounts attributed to revenue recognized to date	37,103	39,936
Progress payments related to long-term contracts and programs	(1,531)	(2,565)
Reserve for excess and obsolete inventory	(5,642)	(6,976)
	$ 68,587	$ 71,789

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(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		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
	(Unaudited)		(Unaudited)	
Net revenue from unaffiliated customers:				
Industrial Group	$ 57,969	$ 67,595	$ 196,884	$ 220,186
Aerospace & Defense	28,123	23,604	78,558	72,655
Test & Measurement	14,065	13,321	41,327	39,365
Electronics Group	42,188	36,925	119,885	112,020
	$ 100,157	$ 104,520	$ 316,769	$ 332,206
Gross profit:				
Industrial Group	$ 306	$ 4,713	$ 12,468	$ 13,782
Aerospace & Defense	2,841	2,471	7,377	6,403
Test & Measurement	3,508	3,288	10,613	9,995
Electronics Group	6,349	5,759	17,990	16,398
	$ 6,655	$ 10,472	$ 30,458	$ 30,180
Operating (loss) income:				
Industrial Group	$ (2,487)	$ 8,271	$ 4,125	$ 12,622
Aerospace & Defense	(1,599)	(660)	(4,344)	(3,548)
Test & Measurement	606	311	1,954	1,709
Electronics Group	(993)	(349)	(2,390)	(1,839)
General, corporate and other	(1,931)	(3,721)	(6,610)	(9,520)
	$ (5,411)	$ 4,201	$ (4,875)	$ 1,263

	September 28, 2008 (Unaudited)	December 31, 2007
Total assets:		
Industrial Group	$ 213,494	$ 264,182
Aerospace & Defense	95,058	108,189
Test & Measurement	31,026	30,337
Electronics Group	126,084	138,526
General, corporate and other	19,484	19,352
	$ 359,062	$ 422,060

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(9) Commitments and Contingencies

The provision for estimated warranty costs is recorded at the time of sale and periodically adjusted to reflect actual experience. A summary of changes in the warranty accrual, which is included in accrued liabilities in the accompanying balance sheets, is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
	(Unaudited)		(Unaudited)	
Balance at the beginning of the period	$ 476	$ 226	$ 522	$ 242
Accruals for warranties for products sold in the period	167	154	468	344
Fulfillment of warranty obligations	(220)	(143)	(542)	(349)
Revisions of estimated obligations			(25)	
Balance at the end of the period	$ 423	$ 237	$ 423	$ 237

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 September 28, 2008, the Company had outstanding purchase commitments of approximately $32,851,000, primarily for the acquisition of inventory and manufacturing equipment. As of September 28, 2008, the Company also had outstanding letters of credit approximating $1,896,000 primarily under a captive insurance program.

(10) Income Taxes

The provision for income taxes includes federal, state, local and foreign taxes. The Company s effective tax rate varies from period to period due to the proportion of foreign and domestic pre-tax income expected to be generated by the Company. The Company expects to generate income in 2008 from its foreign operations, which are taxed at a 28% statutory rate. The Company expects to generate a loss in 2008 from its domestic operations, which are subject to a federal statutory rate of 35%. It is anticipated that the Company will record a valuation allowance against a large portion of the deferred tax asset generated by the domestic operating loss. Reconciling items between the federal statutory rate and the effective tax rate include state income taxes, valuation allowances, provision to return differences and other permanent differences.

The Company recognizes liabilities or assets for the deferred tax consequences of temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS No. 109). These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of assets or liabilities are recovered or settled. SFAS No. 109 requires that a valuation allowance be established when it is more likely than not that all or a portion of a deferred tax asset will not be realized. The Company evaluates its deferred tax position on a quarterly basis and valuation allowances are provided as necessary. During this evaluation, the Company reviews its forecast of income in conjunction with other positive and negative evidence surrounding the realizability of its deferred tax assets to determine if a valuation allowance is needed. Based on the Company s current forecast, a valuation allowance of $4,067,000 was recorded through earnings for the nine months ended September 28, 2008; however,

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there can be no assurances that the Company s forecasts are now, or in the future will be, accurate or that other factors impacting this deferred tax asset will not materially and adversely affect its business, results of operations and financial condition.

The Company s Mexican subsidiary is currently under a routine audit by the Mexican Servicio de Administracion Tributaria (SAT), the Mexican taxing authority, for the periods from May 27, 2004 through July 20, 2007. Proposed audit adjustments, if any, could significantly impact the Company s operating results.

(11) Employee Benefit Plans

Pension benefit consisted of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
	(Unaudited)		(Unaudited)	
Service cost	$ 4	$ 14	$ 54	$ 70
Interest cost on projected benefit obligation	549	525	1,709	1,621
Net amortizations, deferrals and other costs	1	24	55	126
Expected return on plan assets	(800)	(777)	(2,426)	(2,327)
	$ (246)	$ (214)	$ (608)	$ (510)

(12) Other Comprehensive Loss

The Company s accumulated other comprehensive loss consists of the accumulated net unrealized losses on available-for-sale securities, employee benefit related adjustments and foreign currency translation adjustments.

The components of comprehensive (loss) income, net of tax, are as follows for the periods indicated (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
	(Unaudited)		(Unaudited)	
Net (loss) income	$ (7,756)	$ 2,637	$ (8,306)	$ 91
Other comprehensive loss:				
Unrealized loss on available-for-sale securities, net of tax of $276 and $4,178 for the three and nine months ended September 28, 2008, respectively	(1,799)		(38,673)	
Foreign currency translation adjustments	(1,885)	(294)	485	(422)
Total comprehensive (loss) income	$ (11,440)	$ 2,343	$ (46,494)	$ (331)

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

	September 28, 2008 (Unaudited)	December 31, 2007
Foreign currency translation adjustments	$ 1,012	$ 527
Unrealized loss on available-for-sale securities, net of tax	(38,673)	
Employee benefit related adjustments, net of tax	(4,470)	(4,470)
Accumulated other comprehensive loss	$ (42,131)	$ (3,943)

On September 28, 2008 the Company was in compliance with its debt covenants. Such covenants include minimum net worth requirements exclusive of charges to accumulated other comprehensive loss. If the unrealized loss on available-for-sale securities related to the Company s investment in DAN common stock (see Notes 4 and 6) had been recorded through earnings at September 28, 2008, a violation of the minimum net worth covenant would have resulted.

(13) Nonrecurring Items

Nonrecurring items in 2008 include severance and information technology costs related to the decision to merge Sypris Electronics and Sypris Data Systems into a single organization within the Aerospace & Defense segment. Nonrecurring items in 2007 include the gain recognized as part of the Dana settlement agreement offset by the write-off of certain accounts receivable and other assets, legal and professional fees incurred as a result of the Dana Bankruptcy filing and other transaction related costs.

(14) Subsequent Events

On October 10, 2008, the Company received 384,931 common shares of DAN representing approximately 82% of the total 472,000 additional common shares the Company expected to receive as of September 28, 2008 (see Note 4). The Company expects to receive approximately 87,000 additional shares of future distributions, subject to certain settlements by the Dana Corporation bankruptcy estate.

On October 10, 2008, the Board of Directors approved a plan to close the Company s Kenton, Ohio facility. The Kenton, Ohio facility currently employs approximately 117 people. The plan includes the relocation of certain production to the Company s Morganton, North Carolina facility which will begin to transition during the fourth quarter of 2008. Transition of the operation is expected to be completed by the second quarter of 2009.

Since September 28, 2008, the Dow Jones Industrial average has fallen from 11,143 to as low as 8,176 on October 27, 2008. A number of major financial institutions have failed, merged or received involuntary infusions of cash from the United States Treasury Department. The environment for obtaining commercial loans and other forms of debt financing has changed dramatically. Given the rapid pace of regulatory change as well as economic volatility, we are continuing to evaluate the ultimate impact of these developments on our financial condition, estimates, reserves or other aspects of our businesses.

As of November 3, 2008, the closing price for DAN common stock was $2.09 per share. Should the price for DAN stock remain at the November 3, 2008 price and the decline in value be considered other-than-temporary , the Company would be required to take a charge of $56.3 million, net of $5.3 million of income taxes, through its results of operations. Such a charge would likely result in a violation of the Company s minimum net worth covenants under its Revolving Credit Facility and Senior Notes as of December 31, 2008, based on current financial projections. In the event of such an occurrence, the Company would seek a waiver from its current creditors. There can be no assurance that in such an event a waiver could be obtained from the Company s current creditors or if so it would be on terms satisfactory to the Company.

On October 27, 2008, the Company gave notice of its intent to terminate the lease of its 26,300 square foot facility in San Dimas, California. Under the terms of the lease, the Company had a one-time right to terminate the lease at its mid-point in exchange for a $915,000 termination fee. The termination fee, payable in June 2009, will be recorded as a charge to the statement of operations in the fourth quarter consistent with requirements of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*.

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

Results of Operations

The tables presented below, which compare our results of operations for the three and nine month periods from 2008 to 2007, present the results for each period, the change in those results from 2008 to 2007 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 tables 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 tables 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 m