

SYPRIS SOLUTIONS INC  
Form 10-Q  
August 17, 2016

**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 July 3, 2016

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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**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>Six Months Ended</b>	
	<b>July 3, 2016</b>	<b>July 5, 2015</b>	<b>July 3, 2016</b>	<b>July 5, 2015</b>
	<b>(Unaudited)</b>		<b>(Unaudited)</b>	
Net revenue:				
Outsourced services	\$17,587	\$32,942	\$37,344	\$64,814
Products	5,917	7,814	13,098	12,951
Total net revenue	23,504	40,756	50,442	77,765
Cost of sales:				
Outsourced services	18,193	35,326	39,170	71,112
Products	4,589	5,464	9,823	9,844
Total cost of sales	22,782	40,790	48,993	80,956
Gross profit (loss)	722	(34 )	1,449	(3,191 )
Selling, general and administrative	5,241	7,327	11,744	16,445
Research and development	90	195	214	528
Severance	38	281	522	566
Operating loss	(4,647 )	(7,837 )	(11,031 )	(20,730 )
Interest expense, net	964	1,154	1,840	1,488
Other (income), net	(409 )	(575 )	(2,571 )	(754 )
Loss before taxes	(5,202 )	(8,416 )	(10,300 )	(21,464 )
Income tax expense (benefit)	1	0	2	(15 )
Net loss	\$(5,203 )	\$(8,416 )	\$(10,302 )	\$(21,449 )
Loss per share:				
Basic	\$(0.26 )	\$(0.43 )	\$(0.52 )	\$(1.09 )
Diluted	\$(0.26 )	\$(0.43 )	\$(0.52 )	\$(1.09 )
Weighted average shares outstanding:				
Basic	19,749	19,701	19,725	19,675
Diluted	19,749	19,701	19,725	19,675
Dividends declared per common share	\$0.00	\$0.00	\$0.00	\$0.00

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

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**Sypris Solutions, Inc.****Consolidated Statements of Comprehensive Loss****(in thousands)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>July 3, 2016 (Unaudited)</b>	<b>July 5, 2015</b>	<b>July 3, 2016 (Unaudited)</b>	<b>July 5, 2015</b>
Net loss	\$ (5,203)	\$ (8,416)	\$ (10,302)	\$ (21,449)
Other comprehensive loss				
Foreign currency translation adjustments	(669 )	(395 )	(699 )	(1,053 )
Comprehensive loss	\$ (5,872)	\$ (8,811)	\$ (11,001)	\$ (22,502)

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



**Sypris Solutions, Inc.****Consolidated Balance Sheets****(in thousands, except for share data)**

	<b>July 3, 2016 (unaudited)</b>	<b>December 31, 2016</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,819	\$ 1,349
Restricted cash – current	6,000	0
Accounts receivable, net	12,277	12,394
Inventory, net	20,622	20,192
Other current assets	3,624	4,459
Assets held for sale	0	3,230
Total current assets	44,342	41,624
Property, plant and equipment, net	22,330	22,178
Other assets	3,142	3,090
Total assets	\$ 69,814	\$ 66,892
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 10,949	\$ 11,311
Accrued liabilities	14,504	11,661
Revolving credit facility	4,853	2,132
Current portion of long-term debt and capital lease obligations	1,912	1,714
Total current liabilities	32,218	26,818
Long-term debt and capital lease obligations	10,862	8,780
Note payable – related party	6,500	5,500
Other liabilities	10,820	6,082
Total liabilities	60,400	47,180
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; 21,359,736 shares issued and 21,307,044 outstanding in 2016 and 20,826,236 shares issued and 20,776,544 outstanding in 2015	213	208

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Additional paid-in capital	152,775	152,077
Retained deficit	(117,114 )	(106,812 )
Accumulated other comprehensive loss	(26,459 )	(25,760 )
Treasury stock, 52,692 and 49,692 shares in 2016 and 2015, respectively	(1 )	(1 )
Total stockholders' equity	9,414	19,712
Total liabilities and stockholders' equity	\$ 69,814	\$ 66,892

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

**Sypris Solutions, Inc.****Consolidated Cash Flow Statements****(in thousands)**

	<b>Six Months Ended</b>	
	<b>July 3,</b>	<b>July 5,</b>
	<b>2016</b>	<b>2015</b>
	<b>(Unaudited)</b>	
Cash flows from operating activities:		
Net loss	\$(10,302)	\$(21,449)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,678	4,950
Stock-based compensation expense	703	501
Deferred revenue recognized	0	(4,200 )
Deferred loan costs recognized	435	630
Gain on the sale of assets	(2,391 )	0
Provision for excess and obsolete inventory	86	1,125
Other noncash items	(505 )	(1,587 )
Contributions to pension plans	0	(281 )
Changes in operating assets and liabilities:		
Accounts receivable	151	25,317
Inventory	(494 )	1,400
Other current assets	(215 )	(3,006 )
Accounts payable	(369 )	(14,026)
Accrued and other liabilities	2,237	(355 )
Net cash used in operating activities	(6,986 )	(10,981)
Cash flows from investing activities:		
Capital expenditures, net	(115 )	(883 )
Proceeds from sale of assets	11,086	0
Change in restricted cash	(6,000 )	0
Net cash provided by (used in) investing activities	4,971	(883 )
Cash flows from financing activities:		
Principal payments on Term Loan	(857 )	0
Proceeds from note payable - Meritor	0	3,047
Proceeds from related party note payable	1,000	5,500
Net change in debt under revolving credit agreements	2,721	(251 )
Debt issuance and modification costs	(379 )	(1,369 )
Indirect repurchase of shares of minimum statutory tax withholdings	0	(77 )
Cash dividends paid	0	(410 )
Net cash provided by financing activities	2,485	6,440

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Net increase (decrease) in cash and cash equivalents	470	(5,424 )
Cash and cash equivalents at beginning of period	1,349	7,003
Cash and cash equivalents at end of period	\$1,819	\$1,579

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, often 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 two segments, Sypris Technologies, Inc. (Sypris Technologies) and Sypris Electronics, LLC (Sypris Electronics). 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 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 and six months ended July 3, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, and notes thereto, for the year ended December 31, 2015 as presented in the Company’s Annual Report on Form 10-K.

#### **(3) Recent Accounting Pronouncements**

In May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers. This ASU supersedes the revenue recognition requirements in “Accounting Standard Codification 605 - Revenue Recognition” and most industry-specific guidance. The standard requires that entities recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. The new guidance will also require new disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 was originally effective for us on January 1, 2017; however, in July 2015 the FASB decided

to defer the effective date by one year. Early application is not permitted, but reporting entities may choose to adopt the standard as of the original effective date. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is currently assessing the impact of the adoption of ASU 2014-09 on its results of operations, financial position and cash flows. The Company does not intend to early adopt this standard.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements-Going Concern. The new guidance requires management to assess if there is substantial doubt about an entity's ability to continue as a going concern for each annual and interim period. If conditions or events give rise to substantial doubt, disclosures are required. ASU 2014-15 is effective for the annual period ending after December 15, 2016, and for annual and interim periods thereafter; early application is permitted. The Company does not intend to early adopt this standard. The Company is currently assessing the impact of adopting this ASU on its consolidated financial statements and related disclosures.

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The amendments in this ASU 2015-03 require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU 2015-03. In August 2015 the FASB issued ASU No. 2015-15, Interest - Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements - Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting. ASU 2015-15 was issued to address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements that were not found in ASU 2015-03. Given the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements, the ASU provides that the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. These standards are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, and should be applied retrospectively. Early adoption is permitted. The Company adopted this guidance January 1, 2016. As a result of adoption, debt issuance costs of \$1,220,000 were reclassified from assets to reduce long-term-debt as of December 31, 2015.

In July 2015, the FASB issued ASU No. 2015-11, which simplifies the subsequent measurement of inventory. It replaces the current lower of cost or market test with a lower of cost or net realizable value test. The standard is effective for public entities for annual reporting periods beginning after December 15, 2016, and interim periods therein. Early adoption is permitted. The new guidance must be applied prospectively. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The new standard was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This standard affects any entity that enters into a lease, with some specified scope exemptions. The guidance in this update supersedes FASB ASC 840, Leases. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently assessing the impact of adopting this ASU on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting (ASU 2016-09) requiring an entity to record all excess tax benefits and tax deficiencies as an income tax benefit or expense in the income statement. ASU 2016-09 will also require an entity to elect an accounting policy to either estimate the number of forfeitures or account for forfeitures when they occur. ASU 2016-09 becomes effective for the Company during the first quarter 2017. The Company is currently evaluating the effect that the updated standard will have on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations, which further clarifies the implementation guidance on principal versus agent considerations, and in April 2016, the FASB issued ASU 2016-10, Revenue from contracts with customers (Topic 606): Identifying performance obligations and licensing, an update on identifying performance obligations and accounting for licenses of intellectual property. Additionally, in May 2016, the FASB issued ASU 2016-12, Revenue from contracts with customers (Topic 606): Narrow-scope improvements and practical expedients, which includes amendments for enhanced clarification of the guidance. This guidance is effective for fiscal years beginning on or after December 15, 2017 including interim periods within those fiscal years and early adoption is permitted. We are evaluating the impact that adoption of this guidance will have on our consolidated financial statements.

#### **(4) Management's Plans**

Given the Company's loss of market share in commercial vehicle manufacturing in early 2015 due to the nonrenewal of a supply agreement with Dana Holding Corporation ("Dana"), and the recent unfavorable growth trends and softness in commercial vehicle manufacturing and the oil and gas markets served by the Company, management has developed various profit recovery and protection plans and is evaluating strategic alternatives to optimize asset values in each of the Company's segments. Management engaged advisors during various periods to provide recommendations for cost reductions and other actions that can be taken to minimize losses and ultimately return to profitability. Management prepared a revised forecast during early 2016 with plans to further reduce costs, optimize cash flow and remain in compliance with its debt covenant requirements throughout 2016. The Company completed a number of its profit recovery and protection actions during 2015 and the first half of 2016, including: (i) the Toluca Sale-Leaseback (defined below), (ii) the sale of certain assets used in the Company's manufacturing facility in Morganton, North Carolina within the Sypris Technologies segment, (iii) reductions in workforce at all locations, and (iv) other reductions in employment costs through reduced work schedules, senior management pay reductions, deferral of merit increases and certain benefit payments. The Company restructured its debt and has received the benefit of cash infusions from Gill Family Capital Management, Inc. ("GFCM") in the form of subordinated promissory note obligations totaling \$6,500,000 in principal through the first half of 2016.



Demand in the commercial vehicle industry has softened beginning in the fourth quarter of 2015 along with other durable and non-durable goods sectors in the North America economy. In response to the reduced demand, management implemented reductions in selling, general and administrative expense and labor expense during the first half of 2016. Although the expected benefits of the cost reductions were partially offset by the impact of minor investments and severance required to enable the cost reductions, the actions are expected to contribute to improved liquidity during 2016. Additional cost reductions may be implemented during the second half of 2016 if the market softens further.

Management has identified a number of new customer opportunities that are expected to provide higher gross margin opportunities, even at lower volumes. Management is implementing operational efficiencies that are expected to enable reductions in the machinery set-up time for new commercial vehicle orders which should enable the Company to quote on customer requirements that are higher margin but with somewhat shorter run lengths. These new business activities are anticipated to enable the Company to diversify its revenue sources over a larger and more profitable customer base.

One of the additional actions implemented by management during the first quarter of 2016 was to consummate the sale and partial lease back of its facility located in Toluca Mexico, which generated gross proceeds of approximately \$12,182,000. Of these proceeds, \$6,000,000 was deposited into a cash collateral account, to be held for up to one year as additional collateral for the Term Loan (see Note 10 "Debt"). Management will continue to operate in Toluca, but given the reduction in Sypris Technologies' revenues in 2015 and the overall downturn in the commercial vehicle markets beginning in the fourth quarter of 2015, management determined that the underutilized Toluca real estate value could be better optimized with a sale and lease back arrangement where some but not all of the facility would continue to be occupied and managed by Sypris Technologies.

The oil and gas industry has experienced significant price volatility, and as a result the Company's customers are delaying capital expenditures that support their growth and maintenance projects. The Company has identified some capacity reallocation opportunities between plants in the United States and Mexico. The Company has initiated the process of qualifying production for certain components in Mexico that are currently produced in the United States and completed the qualification for the first group of these components. The Company expects this capacity reallocation may accelerate during 2016 as the capital necessary to fund the reallocation becomes available and the qualification process for the production is complete.

Management implemented certain cost reductions at the corporate headquarters that are expected to improve profitability and cash flow throughout 2016. Salary reductions and other SG&A cost reductions were implemented during the first half of 2016 that management believes will continue to benefit the Company throughout future periods. Additional cost reductions have been identified in the area of professional services, administration and lease expenses.

On August 16, 2016, the Company completed the sale of certain assets, intellectual property, contracts and other related assets of Sypris Electronics (the “CSS Sale”) comprised principally of its SioMetrics, Cyber Range, Information Security Solutions and Data Systems product lines (see Note 17 “Subsequent Events”). The retained portion of the Sypris Electronics segment will continue to provide electronic manufacturing and design support services to customers in the aerospace, defense, medical and severe environment markets, among others.

**(5) Morganton Sale**

On July 9, 2015, the Company entered into an asset purchase agreement (the “Agreement”) to sell certain assets used in the Company’s manufacturing facility in Morganton, North Carolina, to its largest customer, Meritor, Inc. (“Meritor”). The Company retained the Morganton plant’s axle shaft manufacturing lines and certain related assets, intellectual property and inventories, which were transitioned to the Company’s Louisville, Kentucky plant in October 2015. All other Morganton equipment, related assets and intellectual property were sold to Meritor (the “Morganton Sale”) for \$10,500,000 in cash paid at the closing and other consideration. Meritor purchased related inventories and accounts receivable and assumed or released certain accounts payable and other accrued liabilities, for \$2,000,000 (subject to customary post-closing adjustments to actual). Meritor also purchased the Morganton building and real estate for \$3,200,000. The total proceeds received of \$15,700,000, primarily in consideration for the Morganton sale, were used to pay down the Company’s prior senior secured debt. As a result of the Morganton sale, the Company recognized a gain of \$7,744,000.

At closing, the parties also entered into an amendment to a secured promissory note with Meritor in an original principal amount of \$3,047,000 (the “Meritor Note”) to increase the principal balance by \$412,000, effective July 9, 2015. The parties also agreed to increase the Meritor Note by an additional \$321,000 in September 2015 to reflect certain roof repairs required at the Morganton facility. The Company repaid the Meritor Note on October 30, 2015.

**(6) Toluca Sale-Leaseback**

On October 30, 2015, the Company entered into a non-binding letter of intent to sell and lease-back its property and buildings in Toluca, Mexico, which is part of the Sypris Technologies Group. As such, the Company concluded that the assets qualified for Assets Held for Sale accounting in accordance with ASC 205 as of December 31, 2015. The assets had a net book value of \$3,230,000 as of December 31, 2015.

On March 9, 2016, Sypris Technologies Mexico, S. de R.L. de C.V. (“Seller”), a subsidiary of the Company, concluded its sale of the 24-acre Toluca property pursuant to an agreement with Promotora y Desarrolladora Pulso Inmobiliario, S.C. (together with its affiliates and assignees, “Buyer”) for 215,000,000 Mexican Pesos, or approximately \$12,182,000 in U.S. currency. Simultaneously, the Seller and the Buyer entered a long-term lease of the 9 acres and buildings currently occupied by Seller and needed for its ongoing business in Toluca (collectively, the “Toluca Sale-Leaseback”). The Company incurred transaction related expenses of \$1,116,000. The Company deposited \$6,000,000 of the proceeds from the sale-leaseback into a Cash Collateral Account, to be held for up to one year as additional collateral for the Term Loan (see Note 10 “Debt” for further discussion on the Term Loan). This amount has been classified as restricted cash on the consolidated balance sheets as of July 3, 2016.

As a result of the Toluca Sale-Leaseback, the Company initially recorded a capital lease of \$3,315,000, which is included in property plant and equipment. The Company recorded a gain on the sale of \$2,370,000 during the six months ended July 3, 2016, which is included in other income, net in the consolidated statement of operations, and recorded a deferred gain of \$5,537,000, which will be recognized over the ten year lease term. The Company’s base rent, which is denominated in U.S. currency, is \$936,000 annually, adjusted based on U.S. CPI with certain cap conditions.

The following assets have been segregated and included in assets held for sale in the consolidated balance sheet as of December 31, 2015 (in thousands):

	<b>December 31, 2015</b>
Land and land improvements	\$ 1,568
Buildings and building improvements	3,658
Accumulated depreciation	(1,996 )
Property, plant and equipment, net	\$ 3,230

**(7) 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. For the three and six months ended July 3, 2016 and July 5, 2015, 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 loss per common share is as follows (in thousands):

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>July 3, 2016</b>	<b>July 5, 2015</b>	<b>July 3, 2016</b>	<b>July 5, 2015</b>
	<b>(Unaudited)</b>		<b>(Unaudited)</b>	
Loss attributable to stockholders:				
Net loss as reported	\$ (5,203 )	\$ (8,416 )	\$ (10,302 )	\$ (21,449 )
Less distributed and undistributed earnings allocable to restricted award holders	0	0	0	0
Less dividends declared attributable to restricted award holders	0	0	0	0
Net loss allocable to common stockholders	\$ (5,203 )	\$ (8,416 )	\$ (10,302 )	\$ (21,449 )
Loss per common share attributable to stockholders:				
Basic	\$ (0.26 )	\$ (0.43 )	\$ (0.52 )	\$ (1.09 )
Diluted	\$ (0.26 )	\$ (0.43 )	\$ (0.52 )	\$ (1.09 )
Weighted average shares outstanding – basic	19,749	19,701	19,725	19,675
Weighted average additional shares assuming conversion of potential common shares	0	0	0	0
Weighted average shares outstanding – diluted	19,749	19,701	19,725	19,675

## **(8) Inventory**

Inventory consists of the following (in thousands):

	<b>July 3, 2016</b>	<b>December 31, 2015</b>
	<b>(Unaudited)</b>	
Raw materials	\$ 12,715	\$ 12,388
Work in process	10,790	10,366
Finished goods	2,816	3,167
Reserve for excess and obsolete inventory	(5,699 )	(5,729 )
	\$ 20,622	\$ 20,192

**(9)Property, Plant and Equipment**

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

	<b>July 3, 2016</b>	<b>December 31, 2015</b>
	<b>(Unaudited)</b>	
Land and land improvements	\$ 219	\$219
Buildings and building improvements	18,305	18,305
Machinery, equipment, furniture and fixtures	124,821	123,935
Construction in progress	677	759
	144,022	143,218
Accumulated depreciation	(121,692 )	(121,040 )
	<b>\$ 22,330</b>	<b>\$22,178</b>

**(10)Debt**

Debt consists of the following:

	<b>July 3, 2016</b>	<b>December 31, 2015</b>
	<b>(Unaudited)</b>	
Current:		
Revolving Credit facility	\$ 4,853	\$ 2,132
Current portion of long term debt	1,714	1,714
Current portion of capital lease obligation	198	0
Current debt	\$ 6,765	\$ 3,846
Long Term:		
Term loan	\$ 9,143	\$ 10,000
Note payable – related party	6,500	5,500
Capital lease obligation	3,066	0
Less unamortized debt issuance and modification costs	(1,347 )	(1,220 )
Long term debt net of unamortized debt costs	\$ 17,362	\$ 14,280

*Note Payable – Related Party*

During 2015, the Company received the proceeds of subordinated indebtedness from GFCM in an amount of \$5,500,000. On February 26, 2016, the Company further amended the GFCM note to increase the amount by \$1,000,000 to \$6,500,000. GFCM is an entity controlled by the Company’s president and chief executive officer, Jeffrey T. Gill and one of our directors, R. Scott Gill. GFCM, Jeffrey T. Gill and R. Scott Gill are significant beneficial stockholders of the Company. The promissory note bears interest at a rate of 8.00% per year. All principal and interest on the promissory note, as amended, will be due and payable on January 30, 2019.

*Revolving Credit Facility and Term Loan*

On October 30, 2015, the Company secured debt financing consisting of a \$12,000,000 term loan (“Term Loan”) and a \$15,000,000 revolving credit facility (“Revolving Credit Facility”). Proceeds from the two new financing arrangements (collectively the “Loan Agreements”) were used in part to repay the senior secured debt with a prior lender and the Meritor Note. Borrowing availability under the Revolving Credit Facility is determined by a weekly borrowing base collateral calculation that includes specified percentages of the value of eligible accounts receivable and inventory,

less certain reserves and subject to certain other adjustments.

On February 25, 2016, the Company entered into an amendment (the “Term Loan Amendment”) to the Term Loan and an amendment (the “Revolving Credit Amendment”) to the Revolving Credit Facility (together, the “Amendments”). The Amendments increased the Company’s borrowing capability under its Revolving Credit Facility and provided for an agreement on use of proceeds from the sale of its Toluca, Mexico property and buildings, as described below.

As a result of the Term Loan Amendment, the Company deposited \$6,000,000 of the proceeds of the sale-leaseback of its Toluca, Mexico property and buildings (the “Toluca Sale-Leaseback”) into a Cash Collateral Account, to be held as additional collateral for the Term Loan. Amounts deposited in the Cash Collateral Account that are subsequently used to pay down the principal of the Term Loan must be accompanied by an additional amount equal to the present value of the avoided interest associated with that principal payment. The Term Loan Amendment also permitted the Company to retain the remaining balance of the proceeds from Toluca Sale-Leaseback, and increased the interest rate of the Term Loan by 1.0%.

In addition, under the Amendments, the Company’s minimum excess availability provision was reduced from \$4,000,000 to \$3,000,000. The lender further agreed to remove certain reserves which had been established against the Company’s “borrowing base.”

The Company’s obligations under each of the Revolving Credit Facility and the Term Loan, as amended, continue to be guaranteed by the Company’s U.S. subsidiaries and are secured by a first priority lien on substantially all assets of the Company and the guarantors.



The Loan Agreements, as amended, contain a number of customary representations and warranties, affirmative, negative and financial maintenance covenants, events of default and remedies upon default, including acceleration and rights to foreclose on the collateral securing each lender. If the Company's borrowing availability under the Revolving Credit Facility falls below \$3,000,000, the Company must maintain a fixed charge coverage ratio of at least 1 to 1, as measured on a trailing twelve months' basis.

The classification of debt as of July 3, 2016 and December 31, 2015 considers debt outstanding under the Loan Agreements on a long-term basis. However, the Revolving Credit Facility allows the lender to establish certain reserves against the borrowing base which could, under certain circumstances, cause a potential event of default. Because such an event is not objectively measureable in advance and because the Company is required to maintain a lock-box arrangement, ASC 470-10-45 requires the otherwise long-term revolving advances to be classified as a current liability. As a result, all borrowings under the Revolving Credit Facility have been classified in the accompanying consolidated balance sheets as a current liability.

On August 16, 2016, the Company repaid the Term Loan in full and paid down the Revolving Credit Facility with proceeds generated from the CSS Sale (see Note 17 "Subsequent Events"). In connection with the repayment of the Term Loan, the \$6,000,000 balance of the Cash Collateral Account was released.

#### *Capital Lease Obligation*

On March 9, 2016, the Company completed the sale of its 24-acre Toluca property pursuant to an agreement with Promotora y Desarrolladora Pulso Inmobiliario, S.C. (together with its affiliates and assignees, "Buyer") for 215,000,000 Mexican Pesos, or approximately \$12,182,000 in U.S. currency. Simultaneously, the Company entered a long-term lease of the 9 acres and buildings currently occupied by the Company and needed for its ongoing business in Toluca (see Note 6 "Toluca Sale-Leaseback"). The Company incurred transaction related expenses of \$1,116,000.

The Company recorded an initial gain on the sale of \$2,370,000 during the six months ended July 3, 2016, which is included in other income, net in the consolidated income statement, and recorded a deferred gain of \$5,155,000 as of July 3, 2016, which will be recognized over the ten year lease term. The Company's base rent, which is denominated in U.S. currency, is \$936,000 annually, adjusted based on U.S. CPI with certain cap conditions. As a result of the Toluca Sale-Leaseback, the Company recorded a capital lease obligation of \$3,264,000 for the building.

The future minimum payments for capital leases as of July 3, 2016 are as follows (in thousands):

	<b>Capital Lease</b>
2016 (remaining 6 months)	\$274
2017	503
2018	549
2019	549
2020	503
Thereafter	2,834
Total future payments	5,212
Less: Amount representing interest	(1,948)
Present value of future minimum payments	3,264
Less: Current portion	(198 )
Long term portion	\$3,066

**(11) Segment Data**

The Company is organized into two business groups, Sypris Technologies and Sypris Electronics. These segments are each managed separately because of the distinctions between the products, services, markets, customers, technologies and workforce skills of the segments. Sypris Technologies provides manufacturing services for a variety of customers that outsource forged and finished steel components and subassemblies. Sypris Technologies also manufactures high-pressure closures and other fabricated products. Sypris Electronics provides manufacturing and technical services as an outsourced service provider and manufactures complex data storage systems, trusted solutions for identity management, cryptographic key distribution and cyber analytics (see Note 17 “Subsequent Events”). 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):

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>July 3, 2016</b>	<b>July 5, 2015</b>	<b>July 3, 2016</b>	<b>July 5, 2015</b>
	<b>(Unaudited)</b>		<b>(Unaudited)</b>	
Net revenue from unaffiliated customers:				
Sypris Technologies	\$14,769	\$32,010	\$32,596	\$60,080
Sypris Electronics	8,735	8,746	17,846	17,685
	\$23,504	\$40,756	\$50,442	\$77,765
Gross profit (loss):				
Sypris Technologies	\$(260 )	\$581	\$(916 )	\$(3,523 )
Sypris Electronics	982	(615 )	2,365	332
	\$722	\$(34 )	\$1,449	\$(3,191 )
Operating (loss) income:				
Sypris Technologies	\$(2,050 )	\$(2,370 )	\$(5,024 )	\$(11,738 )
Sypris Electronics	(909 )	(3,111 )	(1,969 )	(4,701 )
General, corporate and other	(1,688 )	(2,356 )	(4,038 )	(4,291 )
	\$(4,647 )	\$(7,837 )	\$(11,031 )	\$(20,730 )

	<b>July 3, 2016</b>	<b>December 31, 2016</b>
	<b>(Unaudited)</b>	
Total assets:		
Sypris Technologies	\$ 36,838	\$ 38,968
Sypris Electronics	23,534	23,845
General, corporate and other	9,442	4,079
	\$ 69,814	\$ 66,892

## **(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 July 3, 2016 and December 31, 2015, was \$839,000 and \$830,000, respectively. The Company's warranty expense for the six months ended July 3, 2016 and July 5, 2015 was \$52,000 and \$83,000, respectively.

Additionally, the Company sells three and five-year extended warranties for one of its link encryption products. The revenue from the extended warranties is deferred and recognized ratably over the contractual term. As of July 3, 2016

and December 31, 2015, the Company had deferred \$330,000 and \$495,000, 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.

The Company has various current and previously-owned facilities subject to a variety of environmental regulations. The Company has received certain indemnifications either from companies previously owning these facilities or from purchasers of those facilities. As of July 3, 2016 and December 31, 2015, no amounts were accrued for any environmental matters.

As of July 3, 2016, the Company had outstanding purchase commitments of approximately \$9,759,000, primarily for the acquisition of inventory and manufacturing equipment.

The Company accounts for loss contingencies in accordance with U.S. generally accepted accounting principles (GAAP). Estimated loss contingencies are accrued only if the loss is probable and the amount of the loss can be reasonably estimated. With respect to a particular loss contingency, it may be probable that a loss has occurred but the estimate of the loss is within a wide range or undeterminable. If the Company deems an amount within the range to be a better estimate than any other amount within the range, that amount will be accrued. However, if no amount within the range is a better estimate than any other amount, the minimum amount of the range is accrued.

During the fourth quarter of 2015, the Company gave notification regarding its intention to not renew the lease for its Tampa, FL facility, which will expire on December 31, 2016. During the first quarter of 2016, the Company entered into lease negotiations to extend the current lease for a smaller portion of the facility, but was unable to reach an agreement on the economics of a lease renewal with its current landlord. On May 3, 2016, the Company entered a lease for an alternative facility, which it expects to occupy upon the expiration of the current lease. The Company, Sypris Electronics and the landlord of the Tampa facility are currently involved in litigation over certain terms of the lease (see Item 1, "Legal Proceedings"). As such, it is reasonably possible that the Company may be required to make certain repairs to the current facility upon exit. The current estimate of the Company's reasonably possible loss contingency is from no liability to \$4,000,000. While the Company intends to vigorously dispute these claims, the Company accrued \$500,000 during the six months ended July 3, 2016 related to its estimated potential obligation under the lease. This accrual is included in accrued liabilities in the Company's consolidated balance sheet as of July 3, 2016.

### **(13) 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 provides for income taxes for its domestic operations at a statutory rate of 35% and for its foreign operations at a statutory rate of 30% in 2016 and 2015. Reconciling items between the federal statutory rate and the effective tax rate also include the expected usage of federal net operating loss carryforwards, state income taxes, valuation allowances and certain 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 ASC 740, *Income Taxes*. 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. ASC 740 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 its current forecast, the Company has established a valuation allowance against the domestic net deferred tax asset. Until an appropriate level and characterization of profitability is attained, the Company expects to continue to maintain a valuation allowance on its net deferred tax assets related to future U.S. and non-U.S. tax benefits.

As of July 3, 2016 and December 31, 2015, the Company has no undistributed earnings of foreign subsidiaries that are classified as permanently reinvested. The Company did not repatriate any funds to the U.S. during 2015 and expects the repatriation of any available non-U.S. cash holdings during 2016 will be limited to the amount of undistributed earnings as of December 31, 2015. The loss recognized by the Company's Mexican operations during 2015 and the first half of 2016 reduced the undistributed earnings of that entity and the Company has therefore recognized a deferred income tax benefit equal to the reduction in the U.S. deferred tax liability and a corresponding increase in the deferred tax asset valuation allowance. Should the U.S. valuation allowance be released at some future date, the U.S. tax on foreign earnings not permanently reinvested might have a material effect on our effective tax rate.

**(14) Employee Benefit Plans**

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>July 3, 2016</b>	<b>July 5, 2015</b>	<b>July 3, 2016</b>	<b>July 5, 2015</b>
	<b>(Unaudited)</b>		<b>(Unaudited)</b>	
Service cost	\$0	\$3	\$3	\$7
Interest cost on projected benefit obligation	411	411	837	845
Net amortizations, deferrals and other costs	158	177	332	347
Expected return on plan assets	(489)	(558)	(985)	(1,122)
	\$80	\$33	\$187	\$77

**(15) Accumulated Other Comprehensive Loss**

The Company's accumulated other comprehensive loss consists of employee benefit-related adjustments and foreign currency translation adjustments.

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

	<b>July 3, 2015</b>	<b>December 31, 2015</b>
	<b>(Unaudited)</b>	
Foreign currency translation adjustments	\$ (10,253 )	\$ (9,554 )
Employee benefit related adjustments – U.S.	(16,177 )	(16,177 )
Employee benefit related adjustments – Mexico	(29 )	(29 )
Accumulated other comprehensive loss	\$ (26,459 )	\$ (25,760 )

**(16) Fair Value of Financial Instruments**

Cash, accounts receivable, accounts payable and accrued liabilities are reflected in the consolidated financial statements at their carrying amount which approximates fair value because of the short-term maturity of those instruments. The carrying amount of debt outstanding at July 3, 2016 approximates fair value, and is based upon a market approach (Level 2).

**(17) Subsequent Events**

On August 16, 2016, the Company completed the sale of certain assets, intellectual property, contracts and other assets of Sypris Electronics (the “CSS Sale”) comprised principally of its SioMetrics, Cyber Range, Information Security Solutions and Data Systems product lines. The assets were sold for \$42,000,000 in cash consideration, \$1,500,000 of which is to be held in escrow for up to 12 months in connection with certain customary representations, warranties, covenants and indemnifications of the Company. A portion of the proceeds from the CSS Sale was used to pay off the Term Loan and pay down the outstanding balances under the Revolving Credit Facility. The retained portion of the Sypris Electronics segment will continue to provide electronic manufacturing and design support services to customers in the aerospace, defense, medical and severe environment markets, among others.



## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Overview

We are a diversified provider of outsourced services and specialty products. We perform a wide range of manufacturing, engineering, design and other technical services, often under sole-source contracts with corporations and government agencies principally in the markets for industrial manufacturing and aerospace and defense electronics.

We are organized into two business groups, Sypris Technologies and Sypris Electronics. Sypris Technologies, which is comprised of Sypris Technologies, Inc. and its subsidiaries, generates revenue primarily from the sale of manufacturing services to customers in the market for truck components and assemblies and from the sale of products to the energy and chemical markets. Sypris Electronics, which is comprised of Sypris Electronics, LLC and one subsidiary, generates revenue primarily from the sale of manufacturing services, technical services and products to customers in the market for aerospace and defense electronics, trusted solutions for identity management, cryptographic key distribution and cyber analytics.

We focus on those markets where we have the expertise, qualifications and leadership position to sustain a competitive advantage. We target our resources to support the needs of industry leaders that embrace multi-year contractual relationships as a strategic component of their supply chain management. These contracts, many of which are sole-source by part number, historically, have been renewed for sufficient periods to enable us to invest in leading-edge processes or technologies to help our customers remain competitive. The productivity, flexibility and economies of scale that can result offer an important opportunity for differentiating ourselves from our competitors when it comes to cost, quality, reliability and customer service.

### *Sypris Technologies Outlook*

In North America, production levels for light, medium and heavy duty trucks steadily increased from a low in the depressed economic environment of 2008 and 2009 through 2015, but are anticipated to decrease from 2015 to 2016. Production levels for the remainder of 2016 are expected to remain relatively consistent with the lower levels experienced in the first half of 2016 and increase slightly in 2017. Oil and gas markets, served by our engineered products line of Tube Turns® products, have been impacted, as some of our customers' revenues and near term capital expenditures have declined along with oil prices generally. However, the oil and gas outlook appears to be stabilizing as oil prices show signs of recovery and domestic pipeline projects continue to be active.

*Sypris Electronics Outlook*

We have faced challenges within Sypris Electronics, such as the uncertainty in the worldwide macroeconomic climate and its impact on aerospace and defense spending patterns globally, the emergence of new competitors to our product and service offerings, as well as federal government spending uncertainties in the U.S. and the allocation of funds by the U.S. Department of Defense.

Sypris Electronics' revenue had declined from 2009 through 2014 primarily due to our inability to replace the declining demand for certain legacy products and services with competitive new offerings. However, revenues increased in 2015 and in the first half of 2016, as we have begun to generate revenue from the ramp-up of new electronic manufacturing services and other technical service programs.

On August 16, 2016, the Company completed the sale of certain assets, intellectual property, contracts and other assets of Sypris Electronics (the "CSS Sale") comprised principally of its SioMetrics, Cyber Range, Information Security Solutions and Data Systems product lines. The assets were sold for \$42.0 million in cash consideration, \$1.5 million of which is to be held in escrow for up to 12 months in connection with certain customary representations, warranties, covenants and indemnifications of the Company. Also on August 16, 2016, approximately \$15.5 million of the proceeds from the CSS Sale were used to pay off the Term Loan and pay down the Revolving Credit Facility. In connection with the repayment of the Term Loan, the \$6.0 million balance of the Cash Collateral Account was released. See Note 17 "Subsequent Events" to the consolidated financial statements. The retained portion of the Sypris Electronics segment will continue to provide electronic manufacturing and design support services to customers in the aerospace, defense, medical and severe environment markets, among others.

*Management's Plan*

Given the Company's loss of market share in commercial vehicle manufacturing in early 2015 due to the nonrenewal of a supply agreement with Dana Holding Corporation ("Dana") and unfavorable growth trends and softness in commercial vehicle manufacturing and the oil and gas markets served by Sypris Technologies, management has developed various profit recovery and protection plans and is evaluating strategic alternatives to optimize asset values in each of the Company's segments. Management engaged advisors during various periods to provide recommendations for cost reductions and actions that can be taken to improve profitability. Management prepared a revised forecast during early 2016 with plans to further reduce costs, optimize cash flow and remain in compliance with its debt covenant requirements throughout 2016. The Company completed a number of profit recovery and protection actions in 2015 and the first half of 2016, including: (i) the Toluca Sale-Leaseback (defined below), (ii) the sale of certain assets used in the Company's manufacturing facility in Morganton, North Carolina within the Sypris Technologies segment, (iii) reduction in workforce at all locations, and (iv) other reductions in employment costs through reduced work schedules, senior management pay reductions, deferral of merit increases and certain benefit payments.

Additionally, in 2015, the Company's debt was restructured, and the Company has received the benefit of cash infusions from Gill Family Capital Management, Inc. ("GFCM"), an entity controlled by the Company's president and chief executive officer, Jeffrey T. Gill and one of our directors, R. Scott Gill, in the form of subordinated promissory note obligations totaling \$6.5 million in principal through the first half of 2016.

During the first half of 2016, the Company generated additional liquidity through the sale and partial lease back of its facility located in Toluca, Mexico, which generated gross proceeds of approximately \$12.2 million (the "Toluca Sale-Leaseback"). Of these proceeds, \$6.0 million was deposited into a cash collateral account to be held as additional collateral for the Term Loan (see Note 6 "Toluca Sale-Leaseback and Note 10 "Debt" to the consolidated financial statements in this Form 10-Q). Management will continue to operate in Toluca, but given the loss of Dana as a key customer in 2015 and the overall downturn in the commercial vehicle markets, management determined that the underutilized Toluca real estate value could be better optimized with a sale and lease back arrangement where some but not all of the facility would continue to be occupied and managed by Sypris Technologies. The Company's base rent on the lease, which is denominated in U.S. currency, is \$0.9 million annually, adjusted based on U.S. CPI with certain cap conditions.

Demand in the commercial vehicle industry has softened beginning in the fourth quarter of 2015 along with other durable and non-durable goods sectors in the North America economy. In response to the reduced demand, management implemented reductions in selling, general and administrative expense and labor expense during the first half of 2016. Although the expected benefits of the cost reductions were partially offset by the impact of minor investments and severance required to enable the cost reductions, the actions are expected to contribute to improved liquidity during 2016. Additional cost reductions may be implemented during the second half of 2016 if the market softens further.

Management has identified a number of new customer opportunities that are expected to provide higher gross margin opportunities, even at lower volumes. Management is implementing operational efficiencies that are expected to enable reductions in the machinery set-up time for new commercial vehicle orders which should enable the Company to quote on customer requirements that are higher margin but with somewhat shorter run lengths. These new business activities are anticipated to enable the Company to diversify its revenue sources over a larger and more profitable customer base.

The oil and gas industry has experienced significant price volatility, and as a result, the Company's customers are delaying capital expenditures that support their growth and maintenance projects. The Company has identified some capacity reallocation opportunities between plants in the United States and Mexico. The Company has initiated the process of qualifying production for certain components in Mexico that are currently produced in the United States and completed the qualification for the first group of these components. The Company expects the capacity reallocation may accelerate during 2016 as the capital necessary to fund the reallocation becomes available and the qualification process for the production is complete.

Management has identified certain cost reductions at the corporate headquarters that are expected to improve profitability and cash flow throughout 2016. Salary reductions and other selling, general and administrative cost reductions were implemented during the first half of 2016 that management believes will continue to benefit the company throughout future periods. Additional cost reductions have been identified in the area of professional services, administration and lease expense.

Subsequent to the end of the second quarter and in connection with the CSS Sale, management has initiated the process of preparing a long-term business plan for the business units retained by Sypris Electronics after the divestiture. Management intends to include in its plan a continuing effort to grow and diversify its electronic manufacturing service business and the identification of opportunities for cost reductions and cash flow enhancements for the retained portion of the business.

## Results of Operations

The tables below compare our segment and consolidated results for the three and six month periods of operations of 2016 to the three and six month periods of operations of 2015. The tables present the results for each period, the change in those results from 2015 to 2016 in both dollars and percentage change and the results for each period as a percentage of net revenue.

The first two columns in each 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 each 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.”

### Three Months Ended July 3, 2016 Compared to Three Months Ended July 5, 2015

	Three Months Ended,		Year Over Year Change	Year Over Year Percentage Change	Results as Percentage of Net Revenue for the Three Months Ended	
	July 3, 2016	July 5, 2015	Favorable (Unfavorable)	Favorable (Unfavorable)	July 3, 2016	July 5, 2015
<b>(in thousands, except percentage data)</b>						
Net revenue:						
Sypris Technologies	\$14,769	\$32,010	\$ (17,241 )	(53.9 )%	62.8 %	78.5 %
Sypris Electronics	8,735	8,746	(11 )	(0.1 )	37.2	21.5
Total	23,504	40,756	(17,252 )	(42.3 )	100.0	100.0
Cost of sales:						

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Sypris Technologies	15,029	31,429	16,400	52.2	101.8	98.2
Sypris Electronics	7,753	9,361	1,608	17.2	88.8	107.0
Total	22,782	40,790	18,008	44.1	96.9	100.1
Gross profit (loss):						
Sypris Technologies	(260 )	581	(841 )	(144.8 )	(1.8 )	1.8
Sypris Electronics	982	(615 )	1,597	259.7	11.2	(7.0 )
Total	722	(34 )	756	NM	3.1	(0.1 )
Selling, general and administrative	5,241	7,327	2,086	28.5	22.3	18.0
Research and development	90	195	105	53.8	0.4	0.5
Severance	38	281	243	86.5	0.2	0.7
Operating loss	(4,647 )	(7,837 )	3,190	40.7	(19.8 )	(19.2 )
Interest expense, net	964	1,154	190	16.5	4.1	2.8
Other (income), net	(409 )	(575 )	(166 )	(28.9 )	(1.7 )	(1.4 )
Loss before taxes	(5,202 )	(8,416 )	3,214	38.2	(22.1 )	(20.6 )
Income tax (benefit) expense, net	1	—	(1 )	NM	—	—
Net loss	\$(5,203 )	\$(8,416 )	\$ 3,213	38.2	(22.1 )%	(20.6 )%





offsetting this were increases of \$0.9 million and \$1.3 million for the three and six months ended July 3, 2016, respectively, resulting from new business with existing customers.

Sypris Electronics derives its revenue from product sales and technical outsourced services. Net revenue for Sypris Electronics remained flat for the three months ended and increased \$0.2 million for the six months ended July 3, 2016 from the prior year comparable periods. The Company experienced an increase in engineering services and cyber revenue during the periods which was offset by a decrease in engineering manufacturing services due to the completion of a program in 2015.

*Gross Profit.* Sypris Technologies' gross profit decreased to a loss of \$0.3 million for the three months ended July 3, 2016, and increased \$2.6 million to a loss of \$0.9 million for the six months ended July 3, 2016. The Company experienced productivity challenges in the prior year period as a result of the significant loss of business from Dana. Sypris Technologies has continued to adjust its fixed overhead structure in order to better align with current volumes, resulting in improvements in gross profit. Additionally, depreciation expense decreased \$0.4 million and \$0.9 million for the three and six months ended July 3, 2016, respectively, primarily as a result of the sale of the Morganton assets in 2015. Offsetting this was a decrease in gross profit of \$2.1 million \$3.1 million for the three and six months ended July 3, 2016, respectively, resulting from the decrease in volume attributable to lower demand from customers in the commercial vehicle and oil and gas industries.

Sypris Electronics' gross profit increased \$1.6 million and \$2.0 million for in the three and six month periods ended July 3, 2016, respectively. The improvement in gross profit for the three and six months ended July 3, 2016 was primarily as a result of a favorable mix in sales of higher margin products and services in addition to a reduction in the overhead structure from the prior year comparable periods.

*Selling, General and Administrative.* Selling, general and administrative expense decreased by \$2.1 million and \$4.7 million for the three and six month periods ended July 3, 2016, respectively, as compared to the same periods in 2015 primarily as a result of a decrease in legal expenses regarding contract negotiations and the related dispute with Dana, as the litigation is substantially complete. Additionally, the Company initiated various cost reduction activities in 2015 in response to the loss of Dana including employee compensation and headcount reductions and the sale of the Company's Morganton facility (See Note 5, "Morganton Sale" to the consolidated financial statement in this Form 10-Q). Partially offsetting this was a \$0.5 million accrual for a contingent liability related to the exit of one of our leased facilities recorded during the first six months of 2016 (see Note 12 "Commitments and Contingencies" to the consolidated financial statements in this Form 10-Q).

*Research and Development.* Research and development costs were \$0.1 million and \$0.2 million for the three and six months ended July 3, 2016, respectively, as compared to \$0.2 million and \$0.5 million for three and six month comparable 2015 periods in support of Sypris Electronics' self-funded product and technology development activities.

*Severance.* Severance costs were negligible for three months ended and \$0.5 million for the six months ended July 3, 2016 and were comprised exclusively of headcount reductions within Sypris Technologies (See Note 4 "Management's Plans" to the consolidated financial statements in this Form 10-Q).

*Interest Expense.* Interest expense for the three months ended July 3, 2016 decreased \$0.2 million to \$1.0 million as compared to \$1.2 million for the three months ended July 5, 2015. The prior year comparable period included the partial write-off of unamortized loan costs in conjunction with the amendment to the prior credit facility.

Interest expense for the six months ended July 3, 2016 increased \$0.4 million to \$1.8 million primarily due to an increase in interest rates as a result of the Revolving Credit Facility and Term Loan entered into in the fourth quarter of 2015 and the note payable to GFCM, which increased the Company's interest rate structure (see Note 10 "Debt" to the consolidated financial statements in this Form 10-Q).

Our weighted average debt outstanding was \$22.1 million and \$21.1 million for the three and six month periods of 2016, respectively, as compared to \$23.5 million and \$20.6 million during the three and six month periods of 2015, respectively.

*Other (Income) Expense, Net.* The Company recognized other income of \$0.4 million and \$2.6 million for the three and six months ended July 3, 2016 compared to other income of \$0.5 million and \$0.8 million for the three and six months ended July 5, 2015, respectively. Other income, net for the first six months of 2016 includes \$2.4 million related to the gain recognized on the Toluca Sale-Leaseback completed during the first quarter of 2016 (See Note 6 “Toluca Sale-Leaseback” to the consolidated financial statements in this Form 10-Q). Additionally, other income net for the three and six months ended July 3, 2016 includes foreign currency gains of \$0.4 million and \$0.1 million, respectively, related to the net U.S. dollar denominated monetary asset position of our Mexican subsidiaries for which the Mexican peso is the functional currency.

Other income, net for the three and six months ended July 5, 2015 included gains of \$0.5 million from an arbitration settlement and foreign currency gains of \$0.1 million and \$0.2 million, respectively.

## Liquidity, Capital Resources

As described in more detail elsewhere in this report, as a result of the loss of Dana as a key customer, the Company experienced substantially reduced levels of revenue and cash flows in 2015. Additionally, softness in the commercial vehicle market, which began in the fourth quarter of 2015, has continued through the first half of 2016 and is expected to continue through the remainder of the year. These developments have required us to reexamine our strategies, develop recovery plans and cut our costs significantly. Reductions in our available liquidity have also required closer monitoring of the timing of our capital expenditures and cash flows in order to manage our business operations.

In response, we took significant actions during 2015 to pursue new business opportunities with existing and potential customers, identify alternative uses for the related assets and other contingency plans, including the sale of certain assets used in the Company's manufacturing facility in Morganton, North Carolina within the Sypris Technologies segment. In 2015, we received approximately \$15.7 million in total consideration for the Morganton Sale and related transactions, all of which were applied to pay down our senior secured debt (See Note 5 "Morganton Sale" to the consolidated financial statements in this Form 10-Q). On October 30, 2015, the Company's prior senior secured debt was replaced by the Loan Agreements and paid in full. In addition, the Company has received three cash infusions from GFCM, in the form of subordinated promissory note obligations totaling \$6.5 million in principal through the first half of 2016.

Additionally, during the first half of 2016 and, in compliance with the Loan Agreements, the Company entered into the Toluca Sale-Leaseback transaction whereby we sold the entire facility and leased back the portion of the facility currently occupied by the Company in Toluca, Mexico, for our continued use as a manufacturing facility for ten years commencing upon the execution of the lease and terminating on March 9, 2026. The Company's base rent, which is denominated in U.S. currency, is \$0.9 million annually, adjusted based on U.S. CPI with certain cap conditions. The transaction generated gross proceeds of 215.0 million Mexican Pesos, or approximately \$12.2 million dollars in U.S. currency.

On August 16, 2016, the Company completed the sale of certain assets, intellectual property, contracts and other assets of Sypris Electronics (the "CSS Sale") comprised principally of its SioMetrics, Cyber Range, Information Security Solutions and Data Systems product lines. See Note 17 "Subsequent Events" to the consolidated financial statements. The assets were sold for \$42.0 million in cash consideration, \$1.5 million of which is to be held in escrow for up to 12 months in connection with certain customary representations, warranties, covenants and indemnifications of the Company. The retained portion of the Sypris Electronics segment will continue to provide electronic manufacturing and design support services to customers in the aerospace, defense, medical and severe environment markets, among others.

*Revolving Credit Facility and Term Loan.* On October 30, 2015, the Company entered into Loan Agreements providing for a \$12.0 million Term Loan and a \$15.0 million Revolving Credit Facility. Proceeds from the Loan

Agreements were used to repay the prior senior secured debt and the Meritor Note. Borrowing availability under the Revolving Credit Facility is determined by a weekly borrowing base collateral calculation that is based on specified percentages of the value of eligible accounts receivable and inventory, less certain reserves and subject to certain other adjustments.

On February 25, 2016, the Company entered into an amendment (the “Term Loan Amendment”) to the Term Loan and an amendment (the “Revolving Credit Facility Amendment”) to the Revolving Credit Facility (together, the “Amendments”). The Amendments had the effect, among other things, of increasing the Company’s borrowing capability under its Revolving Credit Agreement and providing for an agreement on the use of proceeds from the Toluca Sale-Leaseback, as described below. As part of the Amendments, the Company also received an additional \$1.0 million subordinated loan from GFCM, as described below.

As a result of the Term Loan Amendment, the Company deposited \$6.0 million of the proceeds of the Toluca Sale-Leaseback into a Cash Collateral Account, to be held as additional collateral for the Term Loan. Amounts deposited in the Cash Collateral Account that are subsequently used to pay down the principal of the Term Loan must be accompanied by an additional amount equal to the present value of the avoided interest associated with the principal payment. The Term Loan Amendment further provides that the Company will be permitted to retain the remaining balance of the proceeds from Toluca Sale-Leaseback, and increases the interest rate of the Term Loan by 1.0%.

In addition, under the Term Loan Amendment and Revolving Credit Facility Amendment, the Company's minimum excess availability provisions were reduced from \$4.0 million to \$3.0 million. The lender further agreed to remove certain reserves which were counted against the Company's "borrowing base."

The Company's obligations under each of the Revolving Credit Facility and the Term Loan, as amended, continue to be guaranteed by the Company's U.S. subsidiaries and are secured by a first priority lien on substantially all assets of the Company and the guarantors. Each of the Revolving Credit Facility Amendment and the Term Loan Amendment contains certain customary representations, warranties and covenants.

The Loan Agreements, as amended, contain a number of customary representations and warranties, affirmative, negative and financial maintenance covenants, events of default and remedies upon default, including acceleration and rights to foreclose on the collateral securing each lender. If the Company's borrowing availability under the Revolving Credit Facility falls below \$3.0 million, the Company must maintain a fixed charge coverage ratio of at least 1 to 1, as measured on a trailing twelve months' basis.

On August 16, 2016, approximately \$15.5 million of the proceeds from the CSS Sale were used to pay off the Term Loan and pay down the Revolving Credit Facility. In connection with the repayment of the Term Loan, the \$6.0 million balance of the Cash Collateral Account was released. See Note 17 "Subsequent Events" to the consolidated financial statements.

*Gill Family Capital Management Note.* In connection with the amendments to the prior senior secured debt, the Company received the proceeds of new subordinated indebtedness from GFCM in an amount of \$5.5 million ("GFCM Note"). On February 26, 2016, the Company amended the GFCM Note to increase the amount to \$6.5 million in connection with the amendments to the Revolving Credit Facility and Term Loan. GFCM is an entity controlled by the Company's president and chief executive officer, Jeffrey T. Gill and one of our directors, R. Scott Gill. GFCM, Jeffrey T. Gill and R. Scott Gill are significant beneficial stockholders of the Company. The promissory note bears interest at a rate of 8.0% per year and all principal and interest on the promissory note will be due and payable on the maturity date, January 30, 2019.

*Purchase Commitments.* We also had purchase commitments totaling approximately \$9.8 million at July 3, 2016, primarily for inventory.

## **Cash Flows**

*Operating Activities.* Net cash used by operating activities was \$7.0 million in the first six months of 2016 as compared to net cash used of \$11.0 million in the same period of 2015. Accrued and other liabilities increased resulting in an increase in cash of \$2.2 million. The aggregate decrease in accounts receivable in 2016 provided cash of \$0.2 million. Similarly, decreases in accounts payable, resulted in a usage of cash of \$0.4 million. Cash of \$0.5 million was used to finance an increase in inventory during the first six months of 2016, primarily due to the timing of shipments within Sypris Electronics.

*Investing Activities.* Net cash provided by investing activities was \$5.0 million for the first six months of 2016 as compared to cash used of \$0.9 million for the first six months of 2015. As a result of the Toluca Sale-Leaseback transaction completed in the first quarter of 2016, the Company received net cash proceeds of \$11.1 million. As required under the Term Loan Amendment, the Company deposited \$6.0 million of the proceeds of the Toluca Sale-Leaseback into a Cash Collateral Account, to be held for one year as additional collateral for the Term Loan. Capital expenditures in both periods represented maintenance levels of investment.

*Financing Activities.* Net cash provided by financing activities was \$2.5 million for the first six months of 2016 as compared to \$6.4 million for the first six months of 2015. Net cash provided by financing activities in the first six months of 2016 included proceeds from the subordinated note from Gill Family Capital Management of \$1.0 million and an increase in debt under the Revolving Credit Facility of \$2.7 million. Partially offsetting this were principal payments on the Term Loan of \$0.9 million and financing fees of \$0.4 million in conjunction with the amendments of our Revolving Credit Facility and Term Loan during the first six months of 2016.

Net cash provided by financing activities in the first six months of 2015 included proceeds from the subordinated note from Gill Family Capital Management of \$5.5 million and proceeds from the subordinated note from Meritor of \$3.0 million. Partially offsetting this was a senior secured debt reduction of \$0.3 million, dividend payments of \$0.4 million and payments of \$0.1 million for minimum statutory tax withholding on stock-based compensation. Additionally, we paid \$1.4 million in financing fees in conjunction with the amendments of our senior secured debt in the first six months of 2015.

## **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 and Estimates” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. There have been no significant changes in our critical accounting policies during the six months ended July 3, 2016.

## **Forward-looking Statements**

This Quarterly Report on Form 10-Q, and our other oral or written communications, contain “forward-looking” statements. These statements include our expectations or projections about the future of our industries, business strategies, business and recovery plans, financing sources, liquidity, potential investments, potential acquisitions and dispositions or our financial results or financial condition as well as our views about developments beyond our control, including domestic or global economic conditions, credit markets, trends and market developments. These statements are based on management’s views and assumptions at the time originally made, and, except as required by law, 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 undue reliance should not be placed on these forward-looking statements.

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 currently include: our failure to develop and implement plans to mitigate the impact of loss of revenues from Dana or to adequately diversify our revenue sources on a timely basis; orders received may be cancelled or delayed by our customers, and even if we have a contractual right to manufacture and ship such orders, we must balance such rights against our longer term customer relationships; reliance on major customers or suppliers, including the renewal of significant contracts or the continued provision of trade credit terms despite concerns about our financial condition or liquidity; declining markets or market share in our commercial vehicle and energy-related product lines, especially as we attempt to transition from legacy products and services into new market segments, customers and technologies; the fees, costs and supply of, or access to, debt, equity capital, or other sources of liquidity, including the potentially material costs of our compliance with covenants in, or the potential default under or acceleration of, our new credit facilities; volatility of our customers’ forecasts, scheduling demands and production levels which negatively impact our operational capacity and our effectiveness to integrate new customers or suppliers; dependence on, retention or recruitment of key employees especially in challenging markets; the cost, quality, timeliness, efficiency and yield of our operations and capital investments, including working capital, production schedules, cycle times, scrap rates, injuries, wages, overtime costs, freight or expediting costs; disputes or litigation involving lessor, supplier, customer, employee, landlord, creditor, stockholder, product liability or environmental claims; our ability to successfully develop, launch or sustain new products and programs; inventory valuation risks including excessive or obsolescent valuations; potential impairments, non-recoverability or write-offs of assets or deferred costs; our inability to successfully complete definitive agreements for our targeted acquisitions or



divestitures due to negative due diligence findings or other factors; the costs of compliance with our auditing, regulatory or contractual obligations; our inability to patent or otherwise protect our inventions or other intellectual property from potential competitors; our reliance on third party vendors and sub-suppliers; adverse impacts of new technologies or other competitive pressures which increase our costs or erode our margins; cost and availability of raw materials such as steel, component parts, natural gas or utilities; regulatory actions or sanctions (including FCPA, OSHA and Federal Acquisition Regulations, among others); potential weaknesses in internal controls over financial reporting and enterprise risk management; U.S. government spending on products and services that Sypris Electronics provides, including the timing of budgetary decisions; changes in licenses, security clearances, or other legal rights to operate, manage our work force or import and export as needed; breakdowns, relocations or major repairs of machinery and equipment; pension valuation, health care or other benefit costs; labor relations; strikes; union negotiations; cyber security threats and disruptions; changes or delays in customer budgets, funding or programs; failure to adequately insure or to identify environmental or other insurable risks; revised contract prices or estimates of major contract costs; risks of foreign operations; currency exchange rates; 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, 2015.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We are a smaller reporting company as defined in Item 10(f)(1) of Regulation S-K and thus are not required to provide the quantitative and qualitative disclosures about market risk specified in Item 305 of Regulation S-K.

### **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**

We are involved from time to time in litigation and other legal or environmental proceedings incidental to our business. On November 25, 2013, Sypris Technologies, Inc. initiated an arbitration proceeding against Dana Limited under the Non-Administered Arbitration Rules of the International Institute for Conflict Prevention & Resolution alleging that Dana Limited had entered and then repudiated a five year extension of the parties' long term supply agreement, to run through 2019 or in the alternative had acted in bad faith by refusing to formalize that agreement. On December 30, 2013, Sypris filed a Notice of Supplemental Claims in the same arbitration proceeding, seeking damages for Dana's alleged breach of the parties' original 2007 supply agreement; and Dana filed a counterclaim for certain unpaid price rebates. The arbitrator awarded \$0.5 million to Sypris Technologies and dismissed Dana's claims. On January 17, 2014, Dana initiated a declaratory judgment action in the Court of Common Pleas for Lucas County, Ohio challenging the arbitrability of the existence and enforceability of the extended supply agreement and seeking a ruling that the extended agreement was unenforceable. On February 28, 2015, the Lucas County Court granted Dana's motion, which was subsequently upheld by the Sixth District Court of Appeals for Ohio. Our remaining claim of bad faith and Dana's various potential claims for alleged nonperformance have been mutually released and dismissed.

effective as of May 2, 2016.

On January 15, 2016, Sypris Electronics initiated a declaratory judgment action in the Circuit Court of Hillsborough County, Florida seeking to resolve certain claims made by Sweetwell Industrial Associates, LLP (“Sweetwell”), in a notice of alleged default under our lease in Tampa, Florida. On February 16, 2016, Sweetwell, the landlord under that lease, filed its answer and counterclaim and its third party complaint against the Company, as a guarantor under the lease. The landlord claims that certain repairs must be made immediately and/or at the end of the current lease term. As such, it is reasonably possible that the Company may be required to make certain repairs to the current facility upon exit. The current estimate of the Company’s reasonably possible loss contingency is from no liability to \$4.0 million. While the Company intends to vigorously dispute these claims, the Company accrued \$0.5 million during the six months ended July 3, 2016 related to its estimated potential obligation under the lease. This accrual is included in accrued liabilities in the Company’s consolidated balance sheet as of July 3, 2016. There are currently no other material pending legal proceedings to which we are a party.

**Item 1A. Risk Factors**

Information regarding risk factors appears in Part I — Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Forward-Looking Statements,” in this Quarterly Report on Form 10-Q, and in Part I — Item 1A, “Risk Factors,” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. There have been no material changes during the fiscal quarter from the risk factors disclosed in our Annual Report on Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

**Exhibit Number** **Description**

10.1	Lease between Sypris Electronics, LLC and University Business Center I, LLC dated May 3, 2016 regarding 10421 University Center Drive, Tampa, FL property.
31(i).1	CEO certification pursuant to Section 302 of Sarbanes - Oxley Act of 2002.
31(i).2	Principal Financial Officer certification pursuant to Section 302 of Sarbanes - Oxley Act of 2002.
32	CEO and Principal Financial Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes - Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

**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: August 17, 2016

By: /s/ Anthony C. Allen  
(Anthony C. Allen)  
Vice President & Chief Financial Officer

Date: August 17, 2016

By: /s/ Rebecca R. Eckert  
(Rebecca R. Eckert)  
Controller (Principal Accounting Officer)