

SYPRIS SOLUTIONS INC  
Form 10-Q  
August 14, 2018

**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 1, 2018

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)



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**Part I. Financial Information****Item 1. Financial Statements****Sypris Solutions, Inc.****Condensed Consolidated Statements of Operations****(in thousands, except for per share data)**

|                                       | <b>Three Months<br/>Ended</b> |                         | <b>Six Months<br/>Ended</b> |                         |
|---------------------------------------|-------------------------------|-------------------------|-----------------------------|-------------------------|
|                                       | <b>July 1,<br/>2018</b>       | <b>July 2,<br/>2017</b> | <b>July 1,<br/>2018</b>     | <b>July 2,<br/>2017</b> |
|                                       | <b>(Unaudited)</b>            |                         | <b>(Unaudited)</b>          |                         |
| Net revenue                           | \$22,971                      | \$21,249                | \$42,913                    | \$39,434                |
| Cost of sales                         | 20,037                        | 19,626                  | 37,948                      | 38,358                  |
| Gross profit                          | 2,934                         | 1,623                   | 4,965                       | 1,076                   |
| Selling, general and administrative   | 3,171                         | 3,581                   | 6,319                       | 6,991                   |
| Research and development              | 0                             | 9                       | 0                           | 31                      |
| Severance, relocation and other costs | 305                           | 880                     | 814                         | 1,878                   |
| Operating loss                        | (542 )                        | (2,847 )                | (2,168 )                    | (7,824 )                |
| Interest expense, net                 | 221                           | 206                     | 434                         | 394                     |
| Other (income) expense, net           | (1,623 )                      | 70                      | (1,707 )                    | (1,778 )                |
| Income (loss) before taxes            | 860                           | (3,123 )                | (895 )                      | (6,440 )                |
| Income tax expense (benefit)          | 46                            | 24                      | 86                          | 15                      |
| Net income (loss)                     | \$814                         | \$(3,147 )              | \$(981 )                    | \$(6,455 )              |
| Income (loss) per share:              |                               |                         |                             |                         |
| Basic                                 | \$0.04                        | \$(0.15 )               | \$(0.05 )                   | \$(0.32 )               |
| Diluted                               | \$0.04                        | \$(0.15 )               | \$(0.05 )                   | \$(0.32 )               |

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Weighted average shares outstanding:

|         |        |        |        |        |
|---------|--------|--------|--------|--------|
| Basic   | 20,541 | 20,350 | 20,468 | 20,261 |
| Diluted | 20,855 | 20,350 | 20,468 | 20,261 |

|                                     |        |        |        |        |
|-------------------------------------|--------|--------|--------|--------|
| 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.

**Sypris Solutions, Inc.**

**Condensed Consolidated Statements of Comprehensive Income (Loss)**

(in thousands)

|  | <b>Three Months<br/>Ended<br/>July<br/>1,<br/>2018<br/>(Unaudited)</b> |                         | <b>Six Months<br/>Ended<br/>July 1,<br/>July 2,<br/>2018<br/>(Unaudited)</b> |                         |
|--|--|-------------------------|--|-------------------------|
|  | <b>July 2,<br/>2017</b>  | <b>July 2,<br/>2017</b> | <b>July 1,<br/>2018</b>  | <b>July 2,<br/>2017</b> |
| Net income (loss)                        | \$814  | \$(3,147)               | \$(981)  | \$(6,455)               |
| Other comprehensive (loss) income        |  |                         |  |                         |
| Foreign currency translation adjustments | (506)  | 304                     | (98)   | 1,180                   |
| Comprehensive income (loss)              | \$308  | (2,843)                 | \$(1,079)  | \$(5,275)               |

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

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

|  | <b>July 1,<br/>2018<br/>(Unaudited)</b> | <b>December<br/>31,<br/>2017</b> |
|--|---|----------------------------------|
| <b>Assets</b>  |   |                                  |
| Current assets:  |   |                                  |
| Cash and cash equivalents  | \$ 7,191                                | \$8,144                          |
| Accounts receivable, net   | 12,124                                  | 9,317                            |
| Inventory, net   | 17,555                                  | 17,641                           |
| Other current assets   | 5,552                                   | 2,003                            |
| Assets held for sale   | 2,141                                   | 2,898                            |
| Total current assets   | 44,563                                  | 40,003                           |
| Property, plant and equipment, net   | 14,840                                  | 15,574                           |
| Other assets   | 750                                     | 1,578                            |
| Total assets   | \$ 60,153                               | \$57,155                         |
| <b>Liabilities and Stockholders' Equity</b>  |   |                                  |
| Current liabilities:   |   |                                  |
| Accounts payable   | \$ 13,832                               | \$10,465                         |
| Accrued liabilities  | 11,294                                  | 10,330                           |
| Current portion of capital lease obligations   | 562                                     | 829                              |
| Total current liabilities  | 25,688                                  | 21,624                           |
| Long-term capital lease obligations  | 3,109                                   | 3,397                            |
| Note payable – related party   | 6,442                                   | 6,435                            |
| Other liabilities  | 8,652                                   | 8,769                            |
| Total liabilities  | 43,891                                  | 40,225                           |
| 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                                |



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|   |            |            |
|---|------------|------------|
| Common stock, par value \$0.01 per share, 30,000,000 shares authorized; 21,414,374 shares issued and 21,398,182 outstanding in 2018 and 21,438,269 shares issued and 21,422,077 outstanding in 2017 | 214        | 214        |
| Additional paid-in capital  | 154,099    | 153,858    |
| Accumulated deficit   | (112,402 ) | (111,591 ) |
| Accumulated other comprehensive loss  | (25,649 )  | (25,551 )  |
| Treasury stock, 16,192 shares in 2018 and 2017  | 0          | 0          |
| Total stockholders' equity  | 16,262     | 16,930     |
| Total liabilities and stockholders' equity  | \$ 60,153  | \$ 57,155  |

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

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

|   | <b>Six Months<br/>Ended</b> |                         |
|---|-----------------------------|-------------------------|
|   | <b>July 1,<br/>2018</b>     | <b>July 2,<br/>2017</b> |
|   | <b>(Unaudited)</b>          |                         |
| Cash flows from operating activities:                                       |                             |                         |
| Net loss  | \$(981 )                    | \$(6,455 )              |
| Adjustments to reconcile net loss to net cash used in operating activities: |                             |                         |
| Depreciation and amortization   | 1,310                       | 1,972                   |
| Stock-based compensation expense  | 348                         | 395                     |
| Deferred loan costs recognized  | 7                           | 30                      |
| Net loss (gain) on the sale of assets                                       | 225                         | (2,537 )                |
| Insurance recovery gain   | (2,275 )                    | 0                       |
| Provision for excess and obsolete inventory                                 | (31 )                       | 109                     |
| Other noncash items   | 20                          | 596                     |
| Contributions to pension plans  | (11 )                       | 0                       |
| Changes in operating assets and liabilities:                                |                             |                         |
| Accounts receivable   | (2,807 )                    | (2,915 )                |
| Inventory   | (969 )                      | (9,451 )                |
| Other current assets  | (2,053 )                    | 1,232                   |
| Accounts payable  | 3,368                       | 8,518                   |
| Accrued and other liabilities   | 1,132                       | 2,548                   |
| Net cash used in operating activities                                       | (2,717 )                    | (5,958 )                |
| Cash flows from investing activities:                                       |                             |                         |
| Capital expenditures  | (1,206 )                    | (997 )                  |
| Proceeds from sale of assets  | 1,358                       | 2,623                   |
| Insurance proceeds for recovery of property damage                          | 2,275                       | 0                       |
| Net cash provided by investing activities                                   | 2,427                       | 1,626                   |
| Cash flows from financing activities:                                       |                             |                         |
| Capital lease payments  | (556 )                      | (92 )                   |
| Indirect repurchase of shares of minimum statutory tax withholdings         | (107 )                      | (108 )                  |
| Net cash used in financing activities                                       | (663 )                      | (200 )                  |

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|  |         |          |
|--|---------|----------|
| Net decrease increase in cash and cash equivalents | (953 )  | (4,532 ) |
| Cash and cash equivalents at beginning of period   | 8,144   | 15,270   |
| Cash and cash equivalents at end of period         | \$7,191 | \$10,738 |

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

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**Sypris Solutions, Inc.****Consolidated Statements of Stockholders' equity****(in thousands)**

|  | <b>Common Stock<br/>Shares</b> | <b>Common Stock<br/>Amount</b> | <b>Additional<br/>Paid-In<br/>Capital</b> | <b>Accumulated<br/>Deficit</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> | <b>Treasury<br/>Stock</b> |
|--|--------------------------------|--------------------------------|---|--------------------------------|---|---------------------------|
| January 1, 2017 balance                    | 21,329,690                     | \$ 213                         | \$ 153,252                                | \$ (100,769 )                  | \$ (26,598 )  | \$ 0                      |
| Net loss                                   | 0                              | 0                              | 0   | (6,455 )                       | 0   | 0                         |
| Foreign currency translation<br>adjustment | 0                              | 0                              | 0   | 0                              | 1,180   | 0                         |
| Restricted common stock grant              | 199,000                        | 2                              | (2 )                                      | 0                              | 0   | 0                         |
| Noncash compensation                       | 42,000                         | 0                              | 395                                       | 0                              | 0   | 0                         |
| Treasury stock                             | (33,000 )                      | 0                              | 0   | 0                              | 0   | 0                         |
| Retire treasury stock                      | (101,302 )                     | (1 )                           | (108 )                                    | 0                              | 0   | 0                         |
| July 2, 2017 balance                       | 21,436,388                     | \$ 214                         | \$ 153,537                                | \$ (107,224 )                  | \$ (25,418 )  | \$ 0                      |

|  | <b>Common Stock<br/>Shares</b> | <b>Common Stock<br/>Amount</b> | <b>Additional<br/>Paid-In<br/>Capital</b> | <b>Accumulated<br/>Deficit</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> | <b>Treasury<br/>Stock</b> |
|--|--------------------------------|--------------------------------|---|--------------------------------|---|---------------------------|
| January 1, 2018 balance                    | 21,422,077                     | \$ 214                         | \$ 153,858                                | \$ (111,591 )                  | \$ (25,551 )  | \$ 0                      |
| Net loss                                   | 0                              | 0                              | 0   | (981 )                         | 0   | 0                         |
| Adoption of new accounting<br>standards    | 0                              | 0                              | 0   | 170                            | 0   | 0                         |
| Foreign currency translation<br>adjustment | 0                              | 0                              | 0   | 0                              | (98 )   | 0                         |
| Noncash compensation                       | 42,000                         | 0                              | 348                                       | 0                              | 0   | 0                         |
| Retire treasury stock                      | (65,895 )                      | 0                              | (107 )                                    | 0                              | 0   | 0                         |
| July 1, 2018 balance                       | 21,398,182                     | \$ 214                         | \$ 154,099                                | \$ (112,402 )                  | \$ (25,649 )  | \$ 0                      |

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

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**Sypris Solutions, Inc.**

**Notes to Condensed 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 truck components, oil and gas pipeline components and aerospace and defense electronics. The Company produces a wide range of manufactured products, often under multi-year, sole-source contracts. The Company offers such products through its two business segments, Sypris Technologies, Inc. (“Sypris Technologies”) and Sypris Electronics, LLC (“Sypris Electronics”) (See Note 14).

**(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 accounting principles generally accepted in the United States of America (“U.S. GAAP”) and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the SEC. Accordingly, pursuant to such rules and regulations, certain notes and other financial information included in audited financial statements have been condensed or omitted. The December 31, 2017 consolidated balance sheet data was derived from audited statements, but does not include all disclosures required by U.S. GAAP. The Company’s operations are domiciled in the United States (U.S.) and Mexico, and we 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 1, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, and notes thereto, for the year ended December 31, 2017 as presented in the Company’s Annual Report on Form 10-K.

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

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

In 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09 - Revenue from Contracts with Customers (ASC 606), which supersedes nearly all existing revenue recognition guidance. Subsequent to the issuance of ASU 2014-09, the FASB clarified the new guidance through several additional ASUs; hereinafter the collection of revenue guidance is referred to as “ASC 606.”

ASC 606 is based on the principle that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and any assets recognized from costs incurred to fulfill a contract. The Company adopted the guidance effective January 1, 2018 using the modified retrospective approach for all contracts not completed as of the date of adoption. Results for reporting periods beginning January 1, 2018 are presented under ASC 606, while prior period amounts were not adjusted and continue to be reported in accordance with the Company’s historic accounting under ASC 605, Revenue Recognition.

We recorded a net decrease to beginning accumulated deficit of \$170,000 as of January 1, 2018, for the cumulative impact of adopting the new guidance. The impact primarily arises from a change in how we account for certain federally funded programs within Sypris Electronics where we transfer control of the products to the customer as they are produced (i.e., a change from recognizing revenue at a point in time to recognizing revenue over time, resulting in revenue being recognized earlier in the process of completing the performance obligation).

The following table summarizes the cumulative effect of the changes to our unaudited consolidated balance sheet as of January 1, 2018 from the adoption of ASC 606:

|                               | <b>Balance<br/>at<br/>Dec. 31,<br/>2017</b> | <b>ASC 606<br/>Adjustments</b> | <b>Opening<br/>Balance<br/>at<br/>Jan. 1,<br/>2018</b> |
|-------------------------------|---|--------------------------------|--|
| <b>Assets</b>                 |   |                                |  |
| Inventories – net             | \$17,641                                    | \$ (655 )                      | \$16,986   |
| Contract assets               | 0   | 825                            | 825  |
| <b>Liabilities and Equity</b> |   |                                |  |
| Accumulated deficit           | \$(111,591)                                 | \$ 170                         | \$(111,421)  |

Under the modified retrospective method of adoption, we are also required to disclose in the first year of adoption the hypothetical impact to our financial statements if we had continued to follow our accounting policies under ASC 605 during the period. We estimate that the impact to revenue for the three and six months ended July 1, 2018 would have been a decrease of approximately \$519,000 and \$1,026,000 representing the amount of revenue recognized over time versus at a point in time under ASC 606. Additionally, the adoption of ASC 606 decreased our operating loss and net loss by \$80,000, or \$0.01 per share and \$186,000, or \$0.01 per share, for the three and six months ended July 1, 2018, respectively.

The following table summarizes the effect of adopting ASC 606 on our unaudited consolidated statement of operations for the three months ended July 1, 2018:

|   | <b>As<br/>Reported<br/>July 1,<br/>2018</b> | <b>Impact<br/>of<br/>ASC<br/>606</b> | <b>Legacy<br/>GAAP<br/>July 1,<br/>2018</b> |
|---|---|--------------------------------------|---|
| Net revenue                                     | \$ 22,971                                   | \$ 519                               | \$22,452                                    |
| Cost of sales                                   | 20,037                                      | 439                                  | 19,598                                      |
| Gross profit                                    | 2,934                                       | 80                                   | 2,854                                       |
| Selling, general and administrative             | 3,171                                       | 0                                    | 3,171                                       |
| Severance, equipment relocation and other costs | 305   | 0                                    | 305   |
| Operating loss                                  | (542 )                                      | 80                                   | (622 )                                      |
| Interest expense, net                           | 221   | 0                                    | 221   |
| Other (income), net                             | (1,623 )                                    | 0                                    | (1,623 )                                    |
| Income before taxes                             | 860   | 80                                   | 780   |



|                    |        |       |       |
|--------------------|--------|-------|-------|
| Income tax expense | 46     | 0     | 46    |
| Net income         | \$ 814 | \$ 80 | \$734 |

The following table summarizes the effect of adopting ASC 606 on our unaudited consolidated statement of operations for the six months ended July 1, 2018:

|   | <b>As<br/>Reported<br/>July 1,<br/>2018</b> | <b>Impact<br/>of<br/>ASC<br/>606</b> | <b>Legacy<br/>GAAP<br/>July 1,<br/>2018</b> |
|---|---|--------------------------------------|---|
| Net revenue                                     | \$ 42,913                                   | \$1,026                              | \$41,887                                    |
| Cost of sales                                   | 37,948                                      | 840                                  | 37,108                                      |
| Gross profit                                    | 4,965                                       | 186                                  | 4,779                                       |
| Selling, general and administrative             | 6,319                                       | 0                                    | 6,319                                       |
| Severance, equipment relocation and other costs | 814   | 0                                    | 814   |
| Operating loss                                  | (2,168 )                                    | 186                                  | (2,354 )                                    |
| Interest expense, net                           | 434   | 0                                    | 434   |
| Other (income), net                             | (1,707 )                                    | 0                                    | (1,707 )                                    |
| Loss before taxes                               | (895 )                                      | 186                                  | (1,081 )                                    |
| Income tax expense                              | 86  | 0                                    | 86  |
| Net loss  | \$ (981 )                                   | \$ 186                               | \$(1,167 )                                  |

The following table summarizes the cumulative effect of the changes to our unaudited consolidated balance sheets as of July 1, 2018 from the adoption of ASC 606:

|                               | <b>As<br/>Reported<br/>July 1,<br/>2018</b> | <b>Impact<br/>of<br/>ASC<br/>606</b> | <b>Legacy<br/>GAAP<br/>July 1,<br/>2018</b> |
|-------------------------------|---|--------------------------------------|---|
| <b>Assets</b>                 |   |                                      |   |
| Inventories – net             | \$ 17,555                                   | \$ 1,495                             | \$ 19,050                                   |
| Contract assets               | 1,851                                       | 1,851                                | 0   |
| <b>Liabilities and Equity</b> |   |                                      |   |
| Accumulated deficit           | \$(112,402)                                 | \$ 356                               | \$(112,758)                                 |

In February 2016, the FASB issued ASU No. 2016-02, Leases (ASC 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 Accounting Standards Codification (“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. We believe the adoption of the standard will likely have a material impact to our consolidated balance sheets for the recognition of certain operating leases as right-of-use assets and lease liabilities. We are in the process of analyzing our lease portfolio and evaluating systems to comply with the standard’s retrospective adoption requirements.

In March 2017, the FASB issued ASU No. 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (ASU 2017-07). The update requires employers to present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. The other components of net benefit cost, including interest cost, expected return on plan assets, amortization of prior service cost/credit and actuarial gain/loss, and settlement and curtailment effects, are to be presented outside of any subtotal of operating income. The income statement guidance requires application on a retrospective basis. The Company adopted the ASU on January 1, 2018, and as a result operating income increased \$199,000 and other income decreased by \$199,000 for the six months ended July 2, 2017. The Company used the practical expedient provided in ASU 2017-07 that permits the use of the amounts disclosed in its benefit plans notes for the prior comparative periods as the estimation basis for applying the retrospective presentation requirements. These changes in presentation do not result in any changes to net loss or loss per share. Details of the components of net periodic benefit costs are provided in Note 17.

In February 2018, the FASB issued ASU No. 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (ASU 2018-02). Under existing U.S. GAAP, the effects of changes in tax rates and

laws on deferred tax balances are recorded as a component of income tax expense in the period in which the law was enacted. When deferred tax balances related to items originally recorded in accumulated other comprehensive income are adjusted, certain tax effects become stranded in accumulated other comprehensive income. The amendments in ASU 2018-02 allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 (the “Tax Act”). The amendments in this ASU also require certain disclosures about stranded tax effects. The guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption in any period is permitted. The Company is currently evaluating the timing and impact of adopting ASU 2018-02.

#### **(4) Revenue from Contracts with Customers**

The Company recognizes revenue when it satisfies a performance obligation by transferring control of a promised product or rendering a service to a customer. The amount of revenue recognized reflects the consideration the Company expects to be entitled to in exchange for the product or service (the “transaction price”). The Company’s transaction price in its contracts with customers is generally fixed; no payment discounts, rebates, refunds, or any other forms of variable consideration are included within its contracts. The Company also does not provide service-type warranties either via written agreement or customary business practice, nor does it allow customer returns. In connection with the sale of various parts to customers, the Company is subject to typical assurance warranty obligations covering the compliance of the electronics parts produced to agreed-upon specifications (See Note 15). Customer returns, when they occur, relate to quality rework issues and are not connected to any repurchase obligation of the Company.

A performance obligation is a promise in a contract to transfer a distinct product or render a service to a customer and is the unit of account to which the transaction price is allocated under ASC 606. When a contract contains multiple performance obligations, we allocate the transaction price to the individual performance obligations using the price at which the promised goods or services would be sold to customers on a standalone basis. For most sales within our Sypris Technologies segment and a portion of sales within Sypris Electronics, control transfers to the customer at a point in time. Indicators that control has transferred include the Company having a present right to payment, the customer obtaining legal title and the customer having the significant risks and rewards of ownership. The Company's principal terms of sale are FOB Shipping Point, or equivalent, and, as such, the Company primarily transfers control and records revenue for product sales upon shipment.

For contracts where Sypris Electronics serves as a contractor for aerospace and defense companies under federally funded programs, we generally recognize revenue over time as we perform because of continuous transfer of control to the customer. This continuous transfer of control to the customer is supported by clauses in the contracts that allow the customer to unilaterally terminate the contract for convenience, pay us for costs incurred plus a reasonable profit and take control of any work in process. Because of control transferring over time, revenue is recognized based on the extent of progress towards completion of the performance obligation. We use labor hours incurred as a measure of progress for these contracts because it best depicts the Company's performance of the obligation to the customer, which occurs as we incur labor on our contracts. Under this measure of progress, the extent of progress towards completion is measured based on the ratio of labor hours incurred to date to the total estimated labor hours at completion of the performance obligation.

The majority of our arrangements are for one year or less. For the remaining population of non-cancellable contracts greater than one year we had \$11,677,000 of remaining performance obligations as of July 1, 2018, all of which were long-term Sypris Electronics' contracts. We expect to recognize approximately 20% of our remaining performance obligations as revenue in the six months ended December 31, 2018, 73% in 2019 and the balance thereafter.

*Disaggregation of Revenue*

The following table summarizes revenue from contracts with customers for the three and six months ended July 1, 2018:

| <b>Three<br/>Months</b>            | <b>Six<br/>Months</b>             |
|------------------------------------|-----------------------------------|
| <b>Ended,<br/>July 1,<br/>2018</b> | <b>Ended<br/>July 1,<br/>2018</b> |
| <b>(Unaudited)</b>                 |                                   |

|   |          |          |
|---|----------|----------|
| Sypris Technologies – transferred point in time | \$15,327 | \$29,834 |
| Sypris Electronics – transferred point in time  | 1,240    | 2,154    |
| Sypris Electronics – transferred over time      | 6,404    | 10,925   |
| Net revenue                                     | \$22,971 | \$42,913 |

### *Contract Balances*

Differences in the timing of revenue recognition, billings and cash collections results in billed accounts receivable, unbilled receivables (contract assets) and deferred revenue, customer deposits and billings in excess of revenue recognized (contract liabilities) on the consolidated balance sheets.

*Contract assets* – Contract assets include unbilled amounts typically resulting from sales under contracts where revenue is recognized over time and revenue recognized exceeds the amount billed to the customer, and the right to payment is subject to conditions other than the passage of time. Contract assets are generally classified as current assets in the consolidated balance sheet. The balance of contract assets as of July 1, 2018 and at the date of adoption of ASC 606 were \$1,851,000 and \$825,000, respectively, and are included within other current assets in the accompanying consolidated balance sheets.

*Contract liabilities*— Some of the Company’s contracts within Sypris Electronics are billed as work progresses in accordance with the contract terms and conditions, either at periodic intervals or upon achievement of certain milestones. Often this results in billing occurring prior to revenue recognition resulting in contract liabilities. Additionally, the Company occasionally receives cash payments from customers in advance of the Company’s performance resulting in contract liabilities. These contract liabilities are classified as either current or long-term in the consolidated balance sheet based on the timing of when the Company expects to recognize revenue. As of July 1, 2018 and at the date of adoption of ASC 606, contract liabilities were \$1,691,000 and \$1,509,000, respectively, and are included within accrued liabilities in the accompanying consolidated balance sheets. Payments received from customers in advance of revenue recognition are not considered to be significant financing components because they are used to meet working capital demands that can be higher in the early stages of a contract.

The Company recognized revenue from contract liabilities of \$344,000 and \$1,071,000 for the three and six months ended July 1, 2018, respectively. The Company recognized revenue from contract liabilities of \$1,094,000 and \$1,344,000 for the three and six months ended July 2, 2017, respectively.

*Practical expedients and exemptions*

Sales commissions are expensed when incurred because the amortization period would have been one year or less. These costs are recorded in selling, general and administrative expense in the consolidated statements of operations.

We do not disclose the value of unsatisfied performance obligations for contracts with original expected lengths of one year or less.

**(5) Strategic Actions**

The Company completed a number of strategic actions during the past three years in response to the nonrenewal of supply agreements with certain Tier I automotive customers primarily due to global pricing constraints, the downturn in the commercial vehicle market beginning in the fourth quarter of 2015 and other market and economic factors impacting the Company. Strategic actions taken included: (i) initiation of the Company's exit from the Broadway Plant (defined below) (see Note 6), (ii) the sale of Sypris Electronics' SioMetrics, Cyber Range, Information Security Solutions and Data Systems product lines (the "CSS business") in 2016, (iii) the sale and leaseback of the Company's facility in Toluca, Mexico in 2016, (iv) the sale of the Company's manufacturing facility in Morganton, North Carolina in 2015, (v) the capacity reallocation of certain oil and gas industry components to Mexico, (vi) the relocation of its Sypris Electronics operation to a new facility beginning in 2017, and (vii) reductions in employment costs through reduced work schedules, senior management pay reductions and deferral of merit increases and certain benefit payments. Using a portion of the proceeds generated from the asset sales noted above, the Company paid off all of its most senior secured debt consisting of a "Term Loan" and "Revolving Credit Facility" in August 2016. During this period, the Company also received the benefit of cash infusions from Gill Family Capital Management, Inc. ("GFCM") in the form of secured promissory note obligations totaling \$6,500,000 in principal, originally scheduled to mature in 2019. The GFCM note was amended during 2017 to, among others things, extend the maturity dates so that the note matures in part in 2021, 2023 and 2025 (see Note 13).

The Company has embraced a strategic change in its business by repositioning away from certain of its traditional Tier 1 customers that represent the primary suppliers to the original equipment manufacturers ("OEMs") in the commercial vehicle markets, while targeting to replace these customers with longer-term relationships, especially among the OEMs and others who place a higher value on the Company's innovation, flexibility and core commitment to lean manufacturing principles. Among the customer programs not being renewed was a supply agreement with

Meritor Inc. (“Meritor”), which expired on January 1, 2017, which utilized production at the Company’s Louisville, Kentucky automotive and commercial vehicle manufacturing plant (the “Broadway Plant”). The Company similarly has experienced a reduction in certain portions of its business with Eaton Corporation (“Eaton”). As a result of these decisions, the Company experienced a significant reduction in its commercial vehicle revenues in 2017 (See Note 6).

**(6) Exit and Disposal Activities**

On February 21, 2017, the Board of Directors approved a modified exit or disposal plan with respect to the Broadway Plant, which included the relocation of production to other Company facilities, as needed, and/or the closure of the plant. The relocation of production was complete as of the end of 2017. The Company has relocated certain assets from the Broadway Plant to other manufacturing facilities, as needed, to serve its existing and target customer base and identified underutilized or non-core assets for disposal. Management expects to apply the proceeds from the sale of any underutilized or non-core assets to help fund the costs to transfer any additional equipment from the Broadway Plant. Management is evaluating options for the real estate and any remaining assets in the Broadway Plant in 2018.

As a result of these initiatives, the Company recorded charges of \$814,000, or \$0.04 per share, and \$1,878,000, or \$0.09 per share, during the first six months of 2018 and 2017, respectively, related to the transition of production from the Broadway Plant, which is included in severance, relocation and other costs in the consolidated statement of operations. All \$814,000 incurred during the six months ended July 1, 2018 was recorded within Sypris Technologies. Of these costs, \$224,000 was for equipment relocation costs and \$590,000 for other costs, primarily related to mothball costs associated with the closed facility. The charges for the six months ended July 2, 2017 included \$1,005,000 for severance and benefit related costs and \$873,000 for equipment relocation costs. A summary of the total pre-tax charges is as follows (in thousands):

|                                     | <b>Total</b>   | <b>Costs Incurred</b> |                   | <b>Remaining</b>   |
|-------------------------------------|----------------|-----------------------|-------------------|--------------------|
|                                     | <b>Program</b> | <b>Six</b>            | <b>Total</b>      | <b>Costs to be</b> |
|                                     | <b>1,</b>      | <b>Months</b>         | <b>Recognized</b> | <b>Recognized</b>  |
|                                     | <b>2018</b>    | <b>Ended</b>          | <b>to date</b>    |                    |
|                                     |                | <b>July</b>           |                   |                    |
| Severance and benefit related costs | \$ 1,350       | \$(13 )               | \$ 1,350          | \$ 0               |
| Asset impairments                   | 188            | 0                     | 188               | 0                  |
| Equipment relocation costs          | 1,793          | 224                   | 1,648             | 145                |
| Other                               | 1,089          | 603                   | 633               | 456                |
|                                     | \$ 4,420       | \$ 814                | \$ 3,819          | \$ 601             |

A summary of costs and related reserves for the transition of production from the Broadway Plant at July 1, 2018 is as follows (in thousands):

|                                     | <b>Accrued</b>  |               | <b>Cash</b>       |  | <b>Accrued</b> |
|-------------------------------------|-----------------|---------------|-------------------|--|----------------|
|                                     | <b>Balance</b>  |               | <b>Payments</b>   |  | <b>Balance</b> |
|                                     | <b>at</b>       |               | <b>or Asset</b>   |  | <b>at</b>      |
|                                     | <b>Dec. 31,</b> | <b>2018</b>   | <b>Write-Offs</b> |  | <b>July 1,</b> |
|                                     | <b>2017</b>     | <b>Charge</b> |                   |  | <b>2018</b>    |
| Severance and benefit-related costs | \$ 145          | \$ (13 )      | \$ (126 )         |  | \$ 6           |
| Equipment relocation costs          | 0               | 224           | (224 )            |  | 0              |
| Other                               | 0               | 603           | (603 )            |  | 0              |
|                                     | \$ 145          | \$ 814        | \$ (953 )         |  | \$ 6           |

The Company expects to incur additional pre-tax costs of approximately \$601,000 within Sypris Technologies, the majority of which is expected to be cash expenditures.



As noted above, management expects to apply proceeds from the sale of underutilized or non-core assets to help fund the costs to transfer additional equipment from the Broadway Plant and the transition of the related production. The following assets have been segregated and included in assets held for sale in the consolidated balance sheets (in thousands):

|  | <b>July 1,<br/>2018<br/>(Unaudited)</b> | <b>December<br/>31,<br/>2017</b> |
|--|---|----------------------------------|
| Machinery, equipment, furniture and fixtures | \$ 17,724                               | \$ 28,874                        |
| Accumulated depreciation                     | (15,583 )                               | (25,976 )                        |
| Total assets                                 | \$ 2,141                                | \$ 2,898                         |

### **(7) Property Insurance Settlement**

Subsequent to the transfer of production from the Broadway Plant, the primary water supply and sprinkler pipes within the facility suffered freeze damage during an extended period of extreme cold temperatures. The Company and its insurer reached a full and final settlement agreement with respect to the claim during the second quarter of 2018. Insurance proceeds are recorded to the extent of the losses and then, only if recovery is realized or probable. Any gains in excess of losses are recognized only when the contingencies regarding the recovery are resolved and the amount is fixed or determinable. During the three months ended July 1, 2018, the Company received insurance proceeds of \$2,447,000 and recognized an insurance recovery gain of \$2,275,000, net of expenses incurred for claim related expenses.

The Company is currently evaluating options related to the disposition of the Broadway Plant, including the extent to which repairs, if any, are made to the facility. The Company considered the need for an impairment recognition based on the change in the facility's physical condition following the freeze damage. Although the fair market value of the facility was reduced by the freeze damage, the Company determined the fair market value of the building and land exceeds the net book value as of July 1, 2018.

#### **(8) Other Expense (Income), Net**

As described in Note 3 and Note 17, the Company adopted ASU 2017-07 in the first quarter of 2018. ASU 2017-07 requires the Company to disaggregate the service cost component from the other components of net periodic benefit costs and requires application on a retrospective basis. Accordingly, the other components of net periodic benefit costs included in other income for the three and six-month periods ended July 1, 2018 were \$147,000 and \$322,000 respectively. The components of net periodic benefit costs included in other income for the three and six month periods ended July 2, 2017 were \$43,000 and \$199,000 respectively.

During the six months ended July 1, 2018, the Company recognized an insurance recovery gain of \$2,275,000 related to the settlement of a property insurance claim on the Broadway Plant (see Note 7). Additionally, the Company recognized a net loss of \$225,000 related to the sale of certain idle assets and foreign currency related translation losses of \$28,000 related to the U.S. dollar denominated monetary asset position of our Mexican subsidiaries for which the Mexican peso is the functional currency.

During the six months ended July 2, 2017, the Company recognized net gains of \$2,537,000 related to the sale of idle assets. Additionally, the Company recognized foreign currency related translation losses of \$604,000 related to the U.S. dollar denominated monetary asset position of our Mexican subsidiaries.

#### **(9) Stock-Based Compensation**

During the six months ended July 1, 2018, the Company granted 754,750 options under a long-term incentive program. These awards vest on the third anniversary of the grant date. The options have a five-year term and cliff vest at three years of service. The grants did not have a significant impact on the Company's consolidated financial statements during the three and six months ended July 1, 2018.

#### **(10) Earnings (Loss) Per Common Share**

The Company computes earnings per share using the two-class method, which is an earnings allocation formula that determines earnings per share for common stock and participating securities. Restricted stock granted by the Company is considered a participating security since it contains a non-forfeitable right to dividends.

Our potentially dilutive securities include potential common shares related to our stock options and restricted stock. Diluted earnings per share considers the impact of potentially dilutive securities except in periods in which there is a loss because the inclusion of the potential common shares would have an anti-dilutive effect. Diluted earnings per share excludes the impact of common shares related to our stock options in periods in which the option exercise price is greater than the average market price of our common stock for the period. There were 1,200,250 potential common shares excluded from diluted earnings per share for the three months ended July 1, 2018. For the six months ended July 1, 2018 and the three and six months ended July 2, 2017, 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 income (loss) per common share is as follows (in thousands):

|   | <b>Three Months Ended</b> |                     | <b>Six Months Ended</b> |                     |
|---|---------------------------|---------------------|-------------------------|---------------------|
|   | <b>July 1, 2018</b>       | <b>July 2, 2017</b> | <b>July 1, 2018</b>     | <b>July 2, 2017</b> |
|   | <b>(Unaudited)</b>        |                     | <b>(Unaudited)</b>      |                     |
| Income (loss) attributable to stockholders:                                       |                           |                     |                         |                     |
| Net income (loss) as reported   | \$814                     | \$(3,147)           | \$(981)                 | \$(6,455)           |
| Less distributed and undistributed earnings allocable to restricted award holders | (32)                      | 0                   | 0                       | 0                   |
| Less dividends declared attributable to restricted award holders                  | 0                         | 0                   | 0                       | 0                   |
| Net income (loss) allocable to common stockholders                                | \$782                     | \$(3,147)           | \$(981)                 | \$(6,455)           |
| Income (loss) per common share attributable to stockholders:                      |                           |                     |                         |                     |
| Basic   | \$0.04                    | \$(0.15)            | \$(0.05)                | \$(0.32)            |
| Diluted   | \$0.04                    | \$(0.15)            | \$(0.05)                | \$(0.32)            |
| Weighted average shares outstanding – basic                                       | 20,541                    | 20,350              | 20,468                  | 20,261              |
| Weighted average additional shares assuming conversion of potential common shares | 314                       | 0                   | 0                       | 0                   |
| Weighted average shares outstanding – diluted                                     | 20,855                    | 20,350              | 20,468                  | 20,261              |

## (11) Inventory

Inventory consists of the following (in thousands):

|   | <b>July 1, 2018</b> | <b>December 31, 2017</b> |
|---|---------------------|--------------------------|
|   | <b>(Unaudited)</b>  |                          |
| Raw materials                             | \$ 11,077           | \$ 10,011                |
| Work in process                           | 6,413               | 7,150                    |
| Finished goods                            | 1,257               | 1,645                    |
| Reserve for excess and obsolete inventory | (1,192)             | (1,165)                  |

|       |           |           |
|-------|-----------|-----------|
| Total | \$ 17,555 | \$ 17,641 |
|-------|-----------|-----------|

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

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

|  | <b>July 1,<br/>2018<br/>(Unaudited)</b> | <b>December<br/>31,<br/>2017</b> |
|--|---|----------------------------------|
| Land and land improvements                   | \$ 219                                  | \$ 219                           |
| Buildings and building improvements          | 11,121                                  | 11,140                           |
| Machinery, equipment, furniture and fixtures | 48,331                                  | 49,726                           |
| Construction in progress                     | 1,533                                   | 998                              |
|  | 61,204                                  | 62,083                           |
| Accumulated depreciation                     | (46,364 )                               | (46,509 )                        |
|  | \$ 14,840                               | \$ 15,574                        |

**(13) Debt**

Debt outstanding consists of the following (in thousands):

|   | <b>July 1,<br/>2018<br/>(Unaudited)</b> | <b>December<br/>31,<br/>2017</b> |
|---|---|----------------------------------|
| Current:  |   |                                  |
| Current portion of capital lease obligation           | \$ 562                                  | \$ 829                           |
| Long Term:  |   |                                  |
| Note payable – related party                          | \$ 6,500                                | \$ 6,500                         |
| Capital lease obligation                              | 3,109                                   | 3,397                            |
| Less unamortized debt issuance and modification costs | (58 )                                   | (65 )                            |
| Long term debt net of unamortized debt costs          | \$ 9,551                                | \$ 9,832                         |

*Note Payable – Related Party*

The Company has received the benefit of cash infusions from GFCM in the form of secured promissory note obligations totaling \$6,500,000 in principal as of July 1, 2018 and December 31, 2017. GFCM is an entity controlled by the Company's chairman, 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 until March 31, 2019 and, thereafter, at the greater of 8.0% or 500 basis points above the five-year Treasury note average during the preceding 90-day period, in each case, payable quarterly. The maturity dates for the obligation are as follows: \$2,500,000 of the obligation on April 1, 2021, \$2,000,000 on April 1, 2023 and the balance on April 1, 2025. The note allows for up to an 18-month deferral of payment for up to 60% of the interest due on the portion of the notes maturing in April of 2021 and 2023.

Obligations under the promissory note are guaranteed by all of the subsidiaries and are secured by a first priority lien on substantially all assets of the Company.

*Capital Lease Obligation*

On March 9, 2016, the Company completed the sale of its 24-acre Toluca property for 215,000,000 Mexican Pesos, or approximately \$12,182,000 in U.S. dollars. Simultaneously, the Company entered into a ten-year lease of the 9 acres and buildings currently occupied by the Company and needed for its ongoing business in Toluca. As a result of the Toluca Sale-Leaseback, the Company has a capital lease obligation of \$2,828,000 for the building as of July 1, 2018.

In January 2018, the Company entered into a 36-month capital lease for \$1,277,000 for new production equipment installed at its Sypris Electronics facility during 2017. The balance of the capital lease obligation as of July 1, 2018 was \$843,000.

#### **(14) Segment Data**

The Company is organized into two business segments, Sypris Technologies and Sypris Electronics. The segments are each managed separately because of the distinctions between the products, markets, customers, technologies and workforce skills of the segments. Sypris Technologies manufactures forged and finished steel components and subassemblies, high-pressure closures and other fabricated products. Sypris Electronics is focused on circuit card and full “box build” manufacturing, high reliability manufacturing, systems assembly and integration, design for manufacturability and design to specification work. 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<br/>Ended</b> |                         | <b>Six Months<br/>Ended</b> |                         |
|--|-------------------------------|-------------------------|-----------------------------|-------------------------|
|  | <b>July 1,<br/>2018</b>       | <b>July 2,<br/>2017</b> | <b>July 1,<br/>2018</b>     | <b>July 2,<br/>2017</b> |
|  | <b>(Unaudited)</b>            |                         | <b>(Unaudited)</b>          |                         |
| Net revenue from unaffiliated customers: |                               |                         |                             |                         |
| Sypris Technologies                      | \$15,327                      | \$14,059                | \$29,834                    | \$26,819                |
| Sypris Electronics                       | 7,644                         | 7,190                   | 13,079                      | 12,615                  |
|  | \$22,971                      | \$21,249                | \$42,913                    | \$39,434                |
| Gross profit (loss):                     |                               |                         |                             |                         |
| Sypris Technologies                      | \$1,930                       | \$323                   | \$4,037                     | \$(321)                 |
| Sypris Electronics                       | 1,004                         | 1,300                   | 928                         | 1,397                   |
|  | \$2,934                       | \$1,623                 | \$4,965                     | \$1,076                 |
| Operating (loss) income:                 |                               |                         |                             |                         |
| Sypris Technologies                      | \$374                         | \$(2,069)               | \$679                       | \$(5,209)               |
| Sypris Electronics                       | 362                           | 609                     | (393)                       | 178                     |
| General, corporate and other             | (1,278)                       | (1,387)                 | (2,454)                     | (2,793)                 |
|  | \$(542)                       | \$(2,847)               | \$(2,168)                   | \$(7,824)               |
| Loss (income) before taxes:              |                               |                         |                             |                         |
| Sypris Technologies                      | \$1,930                       | \$(2,227)               | \$2,234                     | \$(3,585)               |
| Sypris Electronics                       | 337                           | 612                     | (436)                       | 181                     |
| General, corporate and other             | (1,407)                       | (1,508)                 | (2,693)                     | (3,036)                 |
|  | \$860                         | \$(3,123)               | \$(895)                     | \$(6,440)               |

|                              | <b>July 1,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|------------------------------|-------------------------|----------------------------------|
|                              | <b>(Unaudited)</b>      |                                  |
| Total assets:                |                         |                                  |
| Sypris Technologies          | \$ 30,406               | \$ 31,725                        |
| Sypris Electronics           | 21,411                  | 17,440                           |
| General, corporate and other | 8,336                   | 7,990                            |
|                              | \$ 60,153               | \$ 57,155                        |
| Total liabilities:           |                         |                                  |
| Sypris Technologies          | \$ 25,275               | \$ 23,854                        |
| Sypris Electronics           | 10,472                  | 8,352                            |
| General, corporate and other | 8,144                   | 8,019                            |
|                              | \$ 43,891               | \$ 40,225                        |



**(15) 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 condensed consolidated balance sheets as of July 1, 2018 and December 31, 2017 was \$556,000 and \$666,000, respectively. The Company's warranty expense for the three and six months ended July 1, 2018 and July 2, 2017 was not material.

The Company bears insurance risk as a member of a group captive insurance entity for certain general liability, automobile and workers' compensation insurance programs, a self-insured worker's compensation program 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 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 accounts for loss contingencies in accordance with U.S. 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 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.

The Company has various current and previously-owned facilities subject to a variety of environmental regulations. The Company has received certain indemnifications from either companies previously owning these facilities or from purchasers of those facilities. As of July 1, 2018 and December 31, 2017, no amounts were accrued for any environmental matters.

On December 27, 2017, the U.S. Department of Labor (the “DOL”) filed a lawsuit alleging that the Company had misinterpreted the language of the Company’s 401(k) Plans (collectively, the “Plan”). The DOL does not appear to dispute that the Company reached such interpretation in good faith and after consulting with independent ERISA counsel. If the DOL’s allegations were upheld by a court, the Company could be required to make additional contributions into the accounts of its Plan participants. The Company regards the DOL’s allegations to be without merit and plans to vigorously defend the matter.

During the year ended December 31, 2017, the Company became aware of a lawsuit involving one of Sypris Electronics’ customers and its primary distributor. This customer informed the Company that, as a result of the lawsuit, the customer would no longer operate its business, and that it has transferred this business to a designated successor. The Company holds \$1,026,000 of inventory related specifically to this customer as of July 1, 2018. On December 21, 2017, the Company entered into a new supply agreement with the designated successor, which provides for purchases of the aforementioned inventory and additional purchases in excess of our inventories on hand and for prices in excess of our cost. No assurances can be given that the successor customer will be successful or will comply with the terms of the new agreement, which could adversely affect our ability to recoup any or all of our investment in these inventories. However, given the uncertainties described above, no estimate currently can be made of a range of amounts of loss that are reasonably possible should the program with the successor not be successful.

As of July 1, 2018, the Company had outstanding purchase commitments of approximately \$17,170,000, primarily for the acquisition of inventory and manufacturing equipment.

**(16) 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 21% and 35% in 2018 and 2017, respectively and for its foreign operations at a statutory rate of 30% in 2018 and 2017. 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 (ASC 740). 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 and foreign 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.

In December 2017, the Tax Act was enacted. The Tax Act includes a number of changes to previous U.S. tax laws that impact the Company, most notably a reduction of the U.S. corporate income tax rate from 35 percent to 21 percent for tax years beginning after December 31, 2017. The Company recognized the income tax effects of the Tax Act in the financial statements included in its 2017 Annual Report on Form 10-K in accordance with Staff Accounting Bulletin No. 118, which provides SEC staff guidance for the application of ASC Topic 740, Income Taxes, in the reporting period in which the Tax Act was signed into law.

The Tax Act also provides that undistributed and previously untaxed post-1986 foreign earnings will be deemed distributed in 2017 and be subject to tax at reduced effective rates (Transition Tax). The Company estimates it has a net cumulative deficit in Earnings & Profits (E&P) from its foreign subsidiaries and, consequently, will not be subject to the Transition Tax. In the event that a final calculation were to result in a nominal Transition Tax, as the Company has a Net Operating Loss in excess of the accumulated E&P of its Mexican subsidiaries as of December 31, 2017, it will not incur a liability for the deemed repatriation of foreign earnings. Additionally, as of July 1, 2018 and December 31, 2017, the Company's U.S. deferred liability for cumulative undistributed earnings has been eliminated.

#### (17) Employee Benefit Plans

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

|   | <b>Three<br/>Months<br/>Ended</b>           |   | <b>Six Months<br/>Ended</b>                 |   |
|---|---|---|---|---|
|   | <b>July<br/>1,<br/>2018<br/>(Unaudited)</b> | <b>July<br/>2,<br/>2017<br/>(Unaudited)</b> | <b>July<br/>1,<br/>2018<br/>(Unaudited)</b> | <b>July<br/>2,<br/>2017<br/>(Unaudited)</b> |
| Service cost                                  | \$0   | \$1   | \$2   | \$3   |
| Interest cost on projected benefit obligation | 325   | 371   | 658   | 759   |
| Net amortizations, deferrals and other costs  | 148   | 163   | 316   | 346   |
| Expected return on plan assets                | (326)                                       | (491)                                       | (652)                                       | (906)                                       |
| Net periodic benefit cost                     | \$147                                       | \$44  | \$324                                       | \$202                                       |

In the first quarter of 2018, the Company adopted ASU 2017-07, which requires the Company to disaggregate the service cost component from other components of net periodic benefit costs and report the service cost component in the same line item as other compensation costs and the other components of net periodic benefit costs (which include interest costs, expected return on plan assets and amortization of actuarial gains and losses) separately and outside a subtotal of operating income. As this ASU requires application on a retrospective basis, the Company restated the prior period presentation for the adoption of this ASU, resulting in a decrease in operating loss and a decrease in other

income of \$43,000 and \$199,000, for the three and six-months ended July 2, 2017, respectively.

The net periodic benefit cost of the defined benefit pension plans incurred during the three and six-month periods ended July 1, 2018 and July 2, 2017 are reflected in the following captions in the accompanying consolidated statements of operations (in thousands):

|  | <b>Three<br/>Months<br/>Ended</b> |                             | <b>Six Months<br/>Ended</b> |                             |
|--|-----------------------------------|-----------------------------|-----------------------------|-----------------------------|
|  | <b>July<br/>1,<br/>2018</b>       | <b>July<br/>2,<br/>2017</b> | <b>July<br/>1,<br/>2018</b> | <b>July<br/>2,<br/>2017</b> |
|  | <b>(Unaudited)</b>                |                             | <b>(Unaudited)</b>          |                             |
| Service cost:                                |                                   |                             |                             |                             |
| Selling, general and administrative expenses | \$0                               | \$(1 )                      | \$(2 )                      | \$(3 )                      |
| Other net periodic benefit costs:            |                                   |                             |                             |                             |
| Other (income), net                          | (147)                             | (43 )                       | (322)                       | (199)                       |
| Total  | \$(147)                           | \$(44 )                     | \$(324)                     | \$(202)                     |

**(18) 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 1,<br/>2018<br/>(Unaudited)</b> | <b>December<br/>31,<br/>2017</b> |
|---|---|----------------------------------|
| Foreign currency translation adjustments      | \$ (11,013 )                            | \$ (10,915 )                     |
| Employee benefit related adjustments – U.S.   | (14,748 )                               | (14,748 )                        |
| Employee benefit related adjustments – Mexico | 112                                     | 112                              |
| Accumulated other comprehensive loss          | \$ (25,649 )                            | \$ (25,551 )                     |

**(19) 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 1, 2018 approximates fair value, and is based upon quoted prices for similar assets and liabilities in active markets, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instruments (Level 2).

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

### **Overview**

We are a diversified provider of truck components, oil and gas pipeline components and aerospace and defense electronics. We offer a wide range of manufactured products, often under multi-year sole-source contracts.

We are organized into two business segments, Sypris Technologies and Sypris Electronics. Sypris Technologies, which is comprised of Sypris Technologies, Inc. and its subsidiaries, generates revenue primarily from the sale of forged, machined, welded and heat-treated steel components and subassemblies including commercial vehicle component parts, high-pressure closures and other fabricated products. Sypris Electronics, which is primarily comprised of Sypris Electronics, LLC, generates revenue primarily through circuit card and full box build manufacturing, high reliability manufacturing, systems assembly and integration, design for manufacturability and design to specification work.

We target those markets where we have the expertise, qualifications and leadership position to sustain a competitive advantage. We focus our resources to support the needs of industry leaders that embrace technological innovation and flexibility, coupled with multi-year contractual relationships where possible, as a strategic component of their supply chain management. Our leading-edge processes and technologies help our customers remain competitive, and the resulting productivity and flexibility offer an important opportunity for differentiating ourselves from our competitors when it comes to cost, quality, reliability and customer service.

### *Sypris Technologies Outlook*

The Sypris Technologies segment continues to migrate from its traditional, concentrated dependence upon the commercial vehicle markets to a more diversified base of customers who place value on our innovation, flexibility and lean manufacturing capabilities. The continued strength of the U.S. dollar, the tightening of margins in certain sectors of the commercial vehicle markets and the generally softening markets led the Company to reevaluate the strategic importance of each of its customers to the Company's long-term success. In connection with this reevaluation process, the Company and Meritor determined not to renew their supply agreement for certain of Meritor's domestic, forged axle shafts beginning in 2017. The Company has had a similar reduction in its business with Eaton. However, the Company continues to supply component parts to Sistemas Automotrices de Mexico, S.A de C.V. ("Sistemas"), Meritor's joint venture in Mexico, and continues to supply axle shafts to Meritor's Brazilian subsidiary.

The oil and gas markets, served by our Tube Turns® brand of engineered product lines, have strengthened along with the overall economy, and domestic pipeline projects continue to be active with U.S. domestic gas and oil production increasing in 2017 and the first half of 2018 and is expected to increase further in the second half of 2018.

We are pursuing new business in a wide variety of markets from light automotive to refrigeration valves to new energy related product lines to achieve a more balanced portfolio across our customers, markets and products. We have recently announced new program awards in each of these markets that are expected to contribute to revenue growth for Sypris Technologies in 2018 and 2019. In certain instances, these awards remain subject to final contract negotiations, however we believe these opportunities provide a solid multi-year foundation for growth and that additional prospective business will result in increased revenue in 2018 and 2019.

#### *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 over the last several years, the emergence of new competitors to our manufacturing capabilities, as well as federal government spending uncertainties in the U.S. and the allocation of funds by the U.S. Department of Defense. More recently, revenues for our electronic manufacturing business increased in 2017 and are expected to increase in 2018, as we have begun to generate revenue from the ramp-up of new electronic manufacturing programs.

We have recently announced new program awards for Sypris Electronics that contributed to revenue in 2017 and 2018, with certain programs continuing into 2019. In addition to program awards related to weapons systems, electronic warfare and infrared countermeasures in our traditional aerospace and defense markets, we have also been awarded programs related to the communication and navigation markets which align with our unique capabilities for delivering products for complex, high cost of failure platforms. The National Defense Authorization Act for Fiscal Year 2018 provides nearly \$700 billion in funding for the U.S. Department of Defense, which is expected to support program growth and market expansion during the coming year for aerospace and defense participants. We expect to compete favorably for follow-on business opportunities on future builds of these programs, as our competitiveness is enhanced by the reduction in our overhead structure following our relocation into a new manufacturing facility as of the beginning of 2017.



In the near term, certain electronic component shortages and extensive lead-time issues are becoming prevalent in many of the segments in the electronic manufacturing industry that we serve. We are working with our customers to qualify alternative components or suppliers to mitigate the impact on our business. The majority of our aerospace and defense programs require specific components that are sole-sourced to specific suppliers; therefore, the resolution of supplier constraints requires coordination with our customers or the end-users of the products.

### *Strategic Actions*

The Company completed a number of strategic actions during the past three years in response to the nonrenewal of its supply agreement with certain Tier I automotive customers primarily due to global pricing constraints, the downturn in the commercial vehicle market beginning in the fourth quarter of 2015 and other market and economic factors impacting the Company during this period. Strategic actions taken included: (i) the initiation of the exit of the Broadway Plant (see discussion below), (ii) the sale of the Company's CSS business in 2016, (iii) the sale and leaseback of the Company's facility in Toluca, Mexico in 2016, (iv) the sale of the Company's manufacturing facility in Morganton, North Carolina in 2015, (v) the capacity reallocation of certain oil and gas industry components to Mexico, (vi) the relocation of its Sypris Electronics operation to a new facility, and (vii) reductions in employment costs through reduced work schedules, senior management pay reductions, deferral of merit increases and certain benefit payments. Using a portion of the proceeds generated from asset sales noted above, the Company paid off all of its most senior, secured debt consisting of a "Term Loan" and "Revolving Credit Facility" in August 2016. During this period, the Company also received the benefit of cash infusions from Gill Family Capital Management, Inc. ("GFCM") in the form of secured promissory note obligations totaling \$6.5 million in principal, scheduled to mature in part in 2021, 2023 and 2025 (see Note 13 to the consolidated financial statements in this Form 10-Q).

The Company has embraced a strategic change in its business by repositioning away from certain of its traditional Tier 1 customers that represent the primary suppliers to the original equipment manufacturers ("OEMs") in the commercial vehicle markets, while targeting to replace these customers with longer-term relationships, especially among the OEMs and others who place a higher value on the Company's innovation, flexibility and core commitment to lean manufacturing principles. Among the customer programs not being renewed was a supply agreement with Meritor Inc. ("Meritor") that expired on January 1, 2017, which utilized production at the Company's Broadway Plant, and the Company has had a similar reduction in certain portions of its business with Eaton. As a result of these decisions, the Company experienced a significant reduction in its commercial vehicle revenues in 2017 (See Note 6 to the consolidated financial statements in this Form 10-Q).

On November 22, 2016, the Board of Directors of the Company approved moving forward with the exploration of a range of strategic options for the Broadway Plant, including the divestiture of the plant, the transitional reduction in its operations to accommodate lower volumes, the relocation of production to other Company facilities as needed, and/or the closure of the plant. Accordingly, management explored various exit or disposal options for the Broadway Plant with the input of our salaried and unionized employees, our customers and others within the industry. On February 21, 2017, with the benefit of management's analysis, the Board of Directors approved a modified exit or disposal plan with respect to the Broadway Plant, which was substantially complete as of the end of 2017. The Company has relocated

certain assets from the Broadway Plant to other manufacturing facilities as needed to serve its existing and targeted customer base and identified underutilized or non-core assets for disposal. Management expects to use the proceeds from the sale of any underutilized or non-core assets to help fund costs of transferring any additional equipment from the Broadway Plant. Management is currently evaluating options for the real estate and any remaining assets in the Broadway Plant in 2018.

Our failure or inability to realize our key financial objectives could materially and adversely impair the Company's ability to operate, its cash flows, financial condition and ongoing results.

## Results of Operations

The tables below compare our segment and consolidated results for the three and six month periods of operations of 2018 to the three and six month periods of operations of 2017. The tables present the results for each period, the change in those results from 2017 to 2018 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 1, 2018 Compared to Three Months Ended July 2, 2017

|                     | Three Months Ended,                    |                 | Year Over     | Year Over     | Results as    |        |   |
|---------------------|--|-----------------|---------------|---------------|---------------|--------|---|
|                     | July 1,<br>2018                        | July 2,<br>2017 | Change        | Change        | Percentage of |        |   |
|                     |  |                 | Favorable     | Favorable     | Net Revenue   |        |   |
|                     |  |                 | (Unfavorable) | (Unfavorable) | for the Three |        |   |
|                     |  |                 |               |               | Months Ended  |        |   |
|                     |  |                 |               |               | July          | July   |   |
|                     |  |                 |               |               | 1,            | 2,     |   |
|                     |  |                 |               |               | 2018          | 2017   |   |
|                     | (in thousands, except percentage data) |                 |               |               |               |        |   |
| Net revenue:        |  |                 |               |               |               |        |   |
| Sypris Technologies | \$15,327                               | \$14,059        | \$ 1,268      | 9.0           | % 66.7        | % 66.2 | % |
| Sypris Electronics  | 7,644                                  | 7,190           | 454           | 6.3           | 33.3          | 33.8   |   |

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|                                       |         |           |          |        |       |         |
|---------------------------------------|---------|-----------|----------|--------|-------|---------|
| Total                                 | 22,971  | 21,249    | 1,722    | 8.1    | 100.0 | 100.0   |
| Cost of sales:                        |         |           |          |        |       |         |
| Sypris Technologies                   | 13,397  | 13,736    | 339      | 2.5    | 87.4  | 97.7    |
| Sypris Electronics                    | 6,640   | 5,890     | (750)    | (12.7) | 86.9  | 81.9    |
| Total                                 | 20,037  | 19,626    | (411)    | (2.1)  | 87.2  | 92.4    |
| Gross profit (loss):                  |         |           |          |        |       |         |
| Sypris Technologies                   | 1,930   | 323       | 1,607    | 497.5  | 12.6  | 2.3     |
| Sypris Electronics                    | 1,004   | 1,300     | (296)    | (22.8) | 13.1  | 18.1    |
| Total                                 | 2,934   | 1,623     | 1,311    | 80.8   | 12.8  | 7.6     |
| Selling, general and administrative   | 3,171   | 3,581     | 410      | 11.4   | 13.8  | 16.9    |
| Research and development              | —       | 9         | 9        | 100.0  | —     | 0.1     |
| Severance, relocation and other costs | 305     | 880       | 575      | 65.3   | 1.3   | 4.1     |
| Operating loss                        | (542)   | (2,847)   | 2,305    | 81.0   | (2.4) | (13.4)  |
| Interest expense, net                 | 221     | 206       | (15)     | (7.3)  | 1.0   | 1.0     |
| Other (income) expense, net           | (1,623) | 70        | (1,693)  | NM     | (7.1) | 0.3     |
| Income (loss) before taxes            | 860     | (3,123)   | 3,983    | NM     | 3.7   | (14.7)  |
| Income tax expense, net               | 46      | 24        | (22)     | (91.7) | 0.2   | 0.1     |
| Net income (loss)                     | \$814   | \$(3,147) | \$ 3,961 | NM     | 3.5 % | (14.8)% |

**Six Months Ended July 1, 2018 Compared to Six Months Ended July 2, 2017.**

|                                       | Six Months Ended,                      |              | Year Over                      | Year Over                      | Results as Percentage of             |              |
|---------------------------------------|--|--------------|--------------------------------|--------------------------------|--------------------------------------|--------------|
|                                       | July 1, 2018                           | July 2, 2017 | Change Favorable (Unfavorable) | Change Favorable (Unfavorable) | Net Revenue for the Six Months Ended |              |
|                                       | (in thousands, except percentage data) |              |                                |                                | July 1, 2018                         | July 2, 2017 |
| Net revenue:                          |  |              |                                |                                |                                      |              |
| Sypris Technologies                   | \$29,834                               | \$26,819     | \$ 3,015                       | 11.2                           | % 69.5                               | % 68.0       |
| Sypris Electronics                    | 13,079                                 | 12,615       | 464                            | 3.7                            | 30.5                                 | 32.0         |
| Total                                 | 42,913                                 | 39,434       | 3,479                          | 8.8                            | 100.0                                | 100.0        |
| Cost of sales:                        |  |              |                                |                                |                                      |              |
| Sypris Technologies                   | 25,797                                 | 27,140       | 1,343                          | 4.9                            | 86.5                                 | 101.2        |
| Sypris Electronics                    | 12,151                                 | 11,218       | (933)                          | (8.3)                          | 92.9                                 | 88.9         |
| Total                                 | 37,948                                 | 38,358       | 410                            | 1.1                            | 88.4                                 | 97.3         |
| Gross profit (loss):                  |  |              |                                |                                |                                      |              |
| Sypris Technologies                   | 4,037                                  | (321)        | 4,358                          | NM                             | 13.5                                 | (1.2)        |
| Sypris Electronics                    | 928                                    | 1,397        | (469)                          | (33.6)                         | 7.1                                  | 11.1         |
| Total                                 | 4,965                                  | 1,076        | 3,889                          | 361.4                          | 11.6                                 | 2.7          |
| Selling, general and administrative   |  |              |                                |                                |                                      |              |
| Research and development              | 6,319                                  | 6,991        | 672                            | 9.6                            | 14.7                                 | 17.7         |
| Severance, relocation and other costs | —                                      | 31           | 31                             | 100.0                          | —                                    | 0.1          |
| Operating loss                        | 814                                    | 1,878        | 1,064                          | 56.7                           | 1.9                                  | 4.8          |
|                                       | (2,168)                                | (7,824)      | 5,656                          | 72.3                           | (5.1)                                | (19.9)       |
| Interest expense, net                 |  |              |                                |                                |                                      |              |
| Other (income), net                   | 434                                    | 394          | (40)                           | (10.2)                         | 1.0                                  | 1.0          |
|                                       | (1,707)                                | (1,778)      | (71)                           | (4.0)                          | (4.0)                                | (4.5)        |
| Loss before taxes                     |  |              |                                |                                |                                      |              |
| Income tax expense, net               | (895)                                  | (6,440)      | 5,545                          | 86.1                           | (2.1)                                | (16.4)       |
|                                       | 86                                     | 15           | (71)                           | (473.3)                        | 0.2                                  | —            |
| Net loss                              | \$(981)                                | \$(6,455)    | \$ 5,474                       | 84.8                           | (2.3)%                               | (16.4)%      |

*Net Revenue.* Sypris Technologies derives its revenue from the sale of forged and finished steel components and subassemblies and high-pressure closures and other fabricated products. Net revenue for Sypris Technologies for the three and six-month periods ended July 1, 2018 increased \$1.3 million and \$3.0 million from the prior year

comparable periods, respectively. The net revenue growth for the comparable three-month periods was primarily attributable to increased sales volume of \$2.2 million with customers in the commercial vehicle market, partially offset by lower energy related product sales of \$0.3 million. The net revenue growth for the comparable six-month periods was primarily attributable to increased sales volume of \$2.6 million with customers in the commercial vehicle market and increased energy related product sales of \$2.1 million. The growth for the three and six-month periods was partially offset by the nonrenewal of the Eaton supply agreement, which accounted for \$0.6 million and \$1.7 million of revenue in the respective prior year periods.

Sypris Electronics derives its revenue primarily from circuit card and full box build manufacturing, high reliability manufacturing and systems assembly and integration. Net revenue for Sypris Electronics increased \$0.5 million for the three and six months ended July 1, 2018, from the prior year comparable periods. Revenue for the first six months of 2018 was affected by shortages of certain electronic components and extensive lead-time issues in the electronic manufacturing industry.

*Gross Profit.* Sypris Technologies' gross profit increased \$1.6 million and \$4.4 million for the three and six months ended July 1, 2018. The net increase in volumes contributed to an increase in gross profit of \$0.2 million and \$1.2 million for the three and six months ended July 1, 2018. Additionally, gross profit for the three and six months ended July 1, 2018 was positively impacted by cost improvements following the transfer of production from our Broadway Plant, which was completed as of the end of 2017.

Sypris Electronics' gross profit decreased \$0.3 million and \$0.5 million for the three and six months ended July 1, 2018, respectively. The decrease in gross profit was primarily as a result of an unfavorable revenue mix, which included the start-up of new programs and shortages of certain electronic components. Certain higher volume, higher margin programs were replaced with the start-up of new programs during the period. The Company expects the component shortages to dissipate during the second half of 2018. The adoption of ASC 606 increased our gross profit by \$0.1 million and \$0.2 million for the three and six months ended July 1, 2018.

*Selling, General and Administrative.* Selling, general and administrative expense decreased by \$0.4 million and \$0.7 million for the three and six month periods ended July 1, 2018, respectively, as compared to the same periods in 2017, primarily as a result of lower employee medical insurance claim expenses during the period as compared to the prior year.

*Severance, Relocation and Other Costs.* Severance, relocation and other costs were \$0.3 million and \$0.8 million for the three and six months ended July 1, 2018, respectively, as compared to \$0.9 million and \$1.9 million for the three and six months ended July 2, 2017. The charges for the first six months of 2018 included \$0.2 million in equipment relocation costs and \$0.6 million in other costs primarily related to mothball costs associated with the closure of the Broadway Plant. Severance, relocation and other costs in 2017 are comprised of accruals related to the anticipated headcount reductions associated with the closure of the Broadway Plant and equipment relocation costs incurred during the quarter (See Note 6 to the consolidated financial statements in this Form 10-Q).

*Other (Income) Expense, Net.* The Company recognized other income, net of \$1.7 million for the six months ended July 1, 2018 compared to \$1.8 million for the six months ended July 2, 2017. As described in Note 3 and Note 17 to the consolidated financial statements, in the first quarter of 2018, the Company adopted ASU No. 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (ASU 2017-07). The ASU requires the Company to disaggregate the service cost component from the other components of net periodic benefit costs and requires application on a retrospective basis. As such, the other components of net periodic benefit costs included in other income for the six months ended July 1, 2018 and July 2, 2017 were \$0.3 million and \$0.2 million, respectively.

During the six months ended July 1, 2018, the Company recognized an insurance recovery gain of \$2.3 million related to proceeds received related to damage sustained at one of its plants (see Note 7). Additionally, the Company recognized a net loss of \$0.2 million related to the sale of idle assets. Foreign currency related losses were not material in the first six months of 2018.

Other income, net for the first six months of 2017 includes \$2.5 million related to the gain recognized on the sale of idle assets within Sypris Technologies. The gain was partially offset by foreign currency related translation losses of \$0.6 million recognized in the first six months of 2017 related to the net U.S. dollar denominated monetary asset position of our Mexican subsidiaries for which the Mexican peso is the functional currency.





## Liquidity, Capital Resources

As a result of Sypris Technologies' nonrenewal of certain supply agreements, the Company experienced substantially reduced levels of revenue and cash flows beginning in 2015. Additionally, revenue declined due to softness in the commercial vehicle market, which began in the fourth quarter of 2015 and continued through 2016. These developments prompted us to re-examine 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.

During 2017, the Company completed the transfer of production and the relocation of certain manufacturing assets from its Broadway Plant to other manufacturing facilities, as needed, to serve its existing and targeted customer base. During the fourth quarter of 2017, the Company terminated all production at the Broadway Plant. As a result of the closure of the Broadway Plant and the transfer of production, the Company is incurring lower employment costs, occupancy and related facility fixed costs and depreciation expense, which is expected to contribute to higher levels of gross profit and operating income for Sypris Technologies.

*Gill Family Capital Management Note.* The Company has received the benefit of cash infusions from GFCM in the form of secured promissory note obligations totaling \$6.5 million in principal as of December 31, 2017 and July 1, 2018. GFCM is an entity controlled by the Company's chairman, 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.

During 2017, the Company amended its secured promissory note obligation with GFCM to, among other things: (i) extend the maturity dates for \$2.5 million of the obligation to April 1, 2021, \$2.0 million to April 1, 2023 and the balance to April 1, 2025, (ii) adjust the interest rate beginning on April 1, 2019 and on each April 1 thereafter, to reflect the greater of 8.0% or 500 basis points above the five-year Treasury note average during the previous 90-day period, (iii) allow for up to an 18-month deferral of payment for up to 60% of the interest due on the notes maturing in April of 2021 and 2023, and (iv) provide for a first security interest in substantially all assets, including those in Mexico.

*Capital Lease Obligations.* On March 9, 2016, the Company completed the sale of its 24-acre Toluca property for 215 million Mexican Pesos, or approximately \$12.2 million in U.S. dollars. Simultaneously, the Company entered into a ten-year lease of the 9 acres and buildings currently occupied by the Company and needed for its ongoing business in Toluca. As a result of the Toluca Sale-Leaseback, the Company has a capital lease obligation of \$2.8 million for the building as of July 1, 2018.

In January 2018, the Company entered into a capital lease for \$1.3 million for new production equipment installed at its Sypris Electronics facility during 2017. The balance of the lease obligation as of July 1, 2018 was \$0.8 million.

*Cash Balance.* At July 1, 2018, we had approximately \$7.2 million of cash and cash equivalents, of which \$0.8 million was held in jurisdictions outside of the U.S. that, if repatriated, could result in withholding taxes.

We have projected that our cash and cash equivalents will be sufficient to allow us to continue operations for the next 12 months. Significant changes from our current forecasts, including, but not limited to: (i) meaningful shortfalls in projected revenue or sales proceeds from underutilized or non-core equipment, (ii) unexpected costs or expenses, and/or (iii) operating difficulties which cause unexpected delays in scheduled shipments, could require us to seek additional funding or force us to make further reductions in spending, extend payment terms with suppliers, liquidate assets where possible and/or suspend or curtail planned programs. Any of these actions could materially harm our business, results of operations and future prospects.

## **Cash Flows**

*Operating Activities.* Net cash used by operating activities was \$2.7 million in the first six months of 2018 as compared to \$6.0 million in the same period of 2017. Cash of \$2.8 million was used to finance increased accounts receivables in the first six months of 2018 as a result of the increase in revenue and the timing of revenue being weighted toward the last month of the period. The investment in inventory in the first six months of 2018 resulted in a usage of cash of \$1.0 million. There was a corresponding increase in accounts payable during the first six months of 2018, which resulted in a source of cash of \$3.4 million. Additionally, accrued and other liabilities increased during the first six months of 2018 primarily as a result of prepayments from customers within Sypris Electronics, resulting in a source of cash of \$1.1 million.

*Investing Activities.* Net cash provided by investing activities was \$2.4 million for the first six months of 2018 as compared to \$1.6 million for the first six months of 2017. Net cash provided by investing activities for the first six months of 2018 includes \$2.3 million from insurance proceeds related to damage sustained at one of its plants from freezing pipes (See Note 7). Additionally, the company received proceeds of \$1.4 million from the sale of idle assets by Sypris Technologies during the period.

Net cash provided by investing activities for the first six months of 2017 includes proceeds of \$2.6 million from the sale of idle assets by Sypris Technologies during the period. Capital expenditures in both periods represented maintenance levels of investment.

*Financing Activities.* Net cash used in financing activities was \$0.7 million for the first six months of 2018 as compared to \$0.2 million for the first six months of 2017. Net cash used in financing activities in the first six months of 2018 included capital lease payments of \$0.6 million and payments of \$0.1 million for minimum statutory tax withholdings on stock-based compensation.

Net cash used in financing activities in the first six months of 2017 included capital lease payments of \$0.1 million and payments of \$0.1 million for minimum statutory tax withholdings on stock-based compensation.

### **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, 2017. Except as set forth below in connection with the adoption of ASC 606, there have been no significant changes in our critical accounting policies during the six months ended July 1, 2018.

*Revenue Recognition.* Refer to Note 4 to the accompanying consolidated financial statements for a description of the Company’s revenue recognition policies.

The Company recognizes revenue when it satisfies a performance obligation by transferring control of a promised product or rendering a service to a customer. The amount of revenue recognized reflects the consideration the Company expects to be entitled to in exchange for the product or service (the “transaction price”). The Company’s transaction price in its contracts with customers is generally fixed; no payment discounts, rebates, refunds, or any other forms of variable consideration are included within its contracts. The Company does not provide service-type

warranties either via written agreement or customary business practice, nor does it allow customer returns. In connection with the sale of various parts to customers, the Company is subject to typical assurance warranty obligations covering the compliance of the electronics parts produced to agreed-upon specifications (See Note 14). Customer returns, when they occur, relate to quality rework issues and are not connected to any repurchase obligation of the Company.

A performance obligation is a promise in a contract to transfer a distinct product or render a service to a customer and is the unit of account to which the transaction price is allocated under ASC 606. When a contract contains multiple performance obligations, we allocate the transaction price to the individual performance obligations using the price at which the promised goods or services would be sold to customers on a standalone basis. For most sales within our Sypris Technologies segment and a portion of sales within Sypris Electronics, control transfers to the customer at a point in time. Indicators that control has transferred include the Company having a present right to payment, the customer obtaining legal title and the customer having the significant risks and rewards of ownership. The Company's principal terms of sale are FOB Shipping Point, or equivalent, and, as such, the Company primarily transfers control and records revenue for product sales upon shipment.

For contracts where Sypris Electronics serves as a contractor for aerospace and defense companies under federally funded programs, we generally recognize revenue over time as we perform because of continuous transfer of control to the customer. This continuous transfer of control to the customer is supported by clauses in the contracts that allow the customer to unilaterally terminate the contract for convenience, pay us for costs incurred plus a reasonable profit and take control of any work in process. Because of control transferring over time, revenue is recognized based on the extent of progress towards completion of the performance obligation. We use labor hours incurred as a measure of progress for these contracts because it best depicts the Company's performance of the obligation to the customer, which occurs as we incur labor on our contracts. Under this measure of progress, the extent of progress towards completion is measured based on the ratio of labor hours incurred to date to the total estimated labor hours at completion of the performance obligation.

## Forward-looking Statements

This Quarterly Report on Form 10-Q, and our other oral or written communications, may contain “forward-looking” statements. These statements may include our expectations or projections about the future of our business, industries, business strategies, prospects, potential acquisitions, liquidity, financial condition or financial results and our views about developments beyond our control, including domestic or global economic conditions, trends and market developments. These statements, including those outlined in management’s recovery plan, 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 estimated income and cash flows includes significant gains and proceeds from the anticipated sale of certain equipment, but there can be no assurances that such sales will be achieved as planned; our failure to return to profitability on a timely basis, which would cause us to continue to use existing cash resources or other assets to fund operating losses; the cost, quality, timeliness, efficiency and yield of our operations and capital investments, including the impact of tariffs, working capital, production schedules, cycle times, scrap rates, injuries, wages, overtime costs, freight or expediting costs; cost and availability of raw materials such as steel, component parts (especially electronic components), natural gas or utilities; inventory valuation risks including excessive or obsolescent valuations or price erosions of raw materials or component parts on hand; breakdowns, relocations or major repairs of machinery and equipment, especially in our Toluca Plant; our failure to successfully complete final contract negotiations with regard to our announced contract “orders”, “wins” or “awards”; dependence on, retention or recruitment of key employees; disputes or litigation involving governmental, supplier, customer, employee, creditor, stockholder, product liability or environmental claims; 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, and in turn cause increases in our inventory and working capital levels; the fees, costs and supply of, or access to, debt, equity capital, or other sources of liquidity; the costs of compliance with our auditing, regulatory or contractual obligations; changes in licenses, security clearances, or other legal rights to operate, manage our work force or import and export as needed; labor relations; strikes; union negotiations; pension valuation, health care or other benefit costs; potential weaknesses in internal controls over financial reporting and enterprise risk management; 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; U.S. government spending on products and services that Sypris Electronics provides, including the timing of budgetary decisions; risks of foreign operations; currency exchange rates; war, terrorism, or political uncertainty; cyber security threats and disruptions; failure to adequately insure or to identify environmental or other insurable risks; 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, 2017.

### **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. Neither we, nor any of our subsidiaries, are currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding currently threatened against us.

### **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, 2017. 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**

| <b>Exhibit<br/>Number</b> | <b><u>Description</u></b>  |
|---------------------------|--|
| 31(i).1                   | <u>CEO certification pursuant to Section 302 of Sarbanes - Oxley Act of 2002.</u>  |
| 31(i).2                   | <u>Principal Financial Officer certification pursuant to Section 302 of Sarbanes - Oxley Act of 2002.</u>  |
| 32                        | <u>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.</u> |
| 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   |

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SYPRIS SOLUTIONS, INC.  
(Registrant)

Date: August 14, 2018 By: /s/ Anthony C. Allen  
(Anthony C. Allen)  
Vice President & Chief Financial Officer

Date: August 14, 2018 By: /s/ Rebecca R. Eckert  
(Rebecca R. Eckert)  
Controller (Principal Accounting Officer)