SYPRIS SOLUTIONS INC
Form 10-Q
November 08, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934**
For the quarterly period ended October 2, 2011

OR

¨ **Transition Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934**
For the transition period from to

Commission file number: 0-24020

SYPRIS SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**61-1321992**
(State or other jurisdiction	**(I.R.S. Employer**
of incorporation or organization)	**Identification No.)**
101 Bullitt Lane, Suite 450	
Louisville, Kentucky 40222	**(502) 329-2000**
(Address of principal executive offices) (Zip code)	**(Registrant s telephone number, including area code)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes x No

As of November 1, 2011 the Registrant had 20,001,401 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SYPRIS SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except for per share data)

	Three Months Ended		Nine Months Ended	
	October 2, 2011	October 3, 2010	October 2, 2011	October 3, 2010
	(Unaudited)		(Unaudited)	
Net revenue:				
Outsourced services	$ 75,574	$ 59,435	$ 209,838	$ 169,693
Products	15,603	13,977	42,207	29,728
Total net revenue	91,177	73,412	252,045	199,421
Cost of sales:				
Outsourced services	68,216	55,543	189,271	157,996
Products	12,698	10,644	36,252	23,840
Total cost of sales	80,914	66,187	225,523	181,836
Gross profit	10,263	7,225	26,522	17,585
Selling, general and administrative	7,232	6,877	20,905	19,949
Research and development	1,097	496	2,637	969
Amortization of intangible assets	24	29	80	85
Nonrecurring income	0	0	(3,000)	0
Restructuring expense, net	356	626	233	2,041
Operating income (loss)	1,554	(803)	5,667	(5,459)
Interest expense, net	153	612	1,608	1,796
Other income, net	(6,489)	(177)	(5,983)	(399)
Income (loss) from continuing operations, before taxes	7,890	(1,238)	10,042	(6,856)
Income tax expense	1,808	457	3,008	1,227
Income (loss) from continuing operations	6,082	(1,695)	7,034	(8,083)
Loss from discontinued operations, net of tax	0	(196)	(450)	(496)
Net income (loss)	$ 6,082	$ (1,891)	$ 6,584	$ (8,579)
Basic income (loss) per share:				
Income (loss) per share from continuing operations	$ 0.30	$ (0.09)	$ 0.35	$ (0.43)
Loss per share from discontinued operations	0.00	(0.01)	(0.02)	(0.03)
Net income (loss) per share	$ 0.30	$ (0.10)	$ 0.33	$ (0.46)
Diluted income (loss) per share:				
Income (loss) per share from continuing operations	$ 0.30	$ (0.09)	$ 0.35	$ (0.43)
Loss per share from discontinued operations	0.00	(0.01)	(0.02)	(0.03)

Net income (loss) per share	$ 0.30	$ (0.10)	$ 0.33	$ (0.46)
Weighted average shares outstanding:				
Basic	18,844	18,628	18,813	18,596
Diluted	19,024	18,628	18,999	18,596

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

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SYPRIS SOLUTIONS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except for share data)

	October 2, 2011 (Unaudited)	December 31, 2010 (Note)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,527	$ 16,592
Accounts receivable, net	54,116	41,434
Inventory, net	36,046	30,264
Prepaid expenses and other current assets	4,052	5,717
Total current assets	109,741	94,007
Restricted cash	3,000	3,000
Investment in marketable securities	1,512	0
Property, plant and equipment, net	60,141	68,590
Goodwill	6,900	6,900
Other assets	6,234	7,195
Total assets	$ 187,528	$ 179,692
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 57,545	$ 39,488
Accrued liabilities	24,872	22,763
Current portion of long-term debt	0	2,000
Total current liabilities	82,417	64,251
Long-term debt	12,500	21,305
Other liabilities	28,263	34,338
Total liabilities	123,180	119,894
Stockholders equity:		
Preferred stock, par value $0.01 per share, 975,150 shares authorized; no sharesissued	0	0
Series A preferred stock, par value $0.01 per share, 24,850 shares authorized; noshares issued	0	0
Common stock, non-voting, par value $0.01 per share, 10,000,000 sharesauthorized; no shares issued	0	0
Common stock, par value $0.01 per share, 30,000,000 shares authorized; 20,108,635 shares issued and 20,014,901 shares outstanding in 2011 and 19,964,348 shares issued and 19,663,229 shares outstanding in 2010	201	199
Additional paid-in capital	148,934	148,555
Retained deficit	(68,045)	(74,629)
Accumulated other comprehensive loss	(16,741)	(14,324)
Treasury stock, 93,734 and 301,119 shares in 2011 and 2010, respectively	(1)	(3)
Total stockholders equity	64,348	59,798
Total liabilities and stockholders equity	$ 187,528	$ 179,692

Note: The balance sheet at December 31, 2010 has been derived from the audited consolidated financial statements at that date but does not include all information and footnotes required by accounting principles generally accepted in the United States for a complete set of financial statements.

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

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SYPRIS SOLUTIONS, INC.

CONSOLIDATED CASH FLOW STATEMENTS

(in thousands)

	Nine Months Ended October 2, 2011	Nine Months Ended October 3, 2010
	(Unaudited)	
Cash flows from operating activities:		
Net income (loss)	$ 6,584	$ (8,579)
Loss from discontinued operations	(450)	(496)
Income (loss) from continuing operations	7,034	(8,083)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	10,791	11,083
Stock-based compensation expense	754	776
Deferred revenue recognized	(5,163)	(4,584)
Deferred loan costs recognized	153	287
Write-off of debt issuance costs	277	0
Gain on sale of assets	(4,189)	(600)
Provision for excess and obsolete inventory	564	727
Other noncash items	(2,186)	669
Contributions to pension plans	(753)	(790)
Change in operating assets and liabilities:		
Accounts receivable	(12,632)	(8,819)
Inventory	(6,346)	(3,012)
Prepaid expenses and other assets	1,138	326
Accounts payable	17,793	10,134
Accrued and other liabilities	1,974	1,688
Net cash provided by (used in) operating activities	9,209	(198)
Cash flows from investing activities:		
Capital expenditures, net	(3,827)	(1,003)
Proceeds from sale of assets	4,637	721
Changes in nonoperating assets and liabilities	44	7
Net cash provided by (used in) investing activities	854	(275)
Cash flows from financing activities:		
Repayment of former Revolving Credit Agreement	(10,000)	0
Repayment of former Senior Notes	(13,305)	0
Net proceeds from Credit Facility	12,500	0
Payments for deferred loan costs	(387)	0
Proceeds from the issuance of common stock	64	0
Net cash used in financing activities	(11,128)	0
Net decrease in cash and cash equivalents	(1,065)	(473)
Cash and cash equivalents at beginning of period	16,592	15,608
Cash and cash equivalents at end of period	$ 15,527	$ 15,135

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

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SYPRIS SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Nature of Business

Sypris is a diversified provider of outsourced services and specialty products. The Company performs a wide range of manufacturing, engineering, design and other technical services, typically under multi-year, sole-source contracts with corporations and government agencies in the markets for truck components and assemblies and aerospace and defense electronics. The Company provides such services through its Industrial and Electronics Groups (Note 14).

(2) Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Sypris Solutions, Inc. and its wholly-owned subsidiaries (collectively, Sypris or the Company), and have been prepared by the Company in accordance with the rules and regulations of the Securities and Exchange Commission. The Company s operations are domiciled in the United States (U.S.), Mexico and Denmark and service a wide variety of domestic and international customers. All significant intercompany transactions and accounts have been eliminated. These unaudited consolidated financial statements reflect, in the opinion of management, all material adjustments (which include only normal recurring adjustments) necessary to fairly state the results of operations, financial position and cash flows for the periods presented, and the disclosures herein are adequate to make the information presented not misleading. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Actual results for the three and nine months ended October 2, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements, and notes thereto, for the year ended December 31, 2010 as presented in the Company s Annual Report on Form 10-K.

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

(3) Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05 which provides new guidance on the presentation of comprehensive income. ASU 2011-05 eliminates the option to report other comprehensive income and its components in the statement of changes in stockholders equity and instead requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement or in two separate but consecutive statements. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. The adoption of this ASU will not have a significant impact on the Company s consolidated financial statements, as it only requires a change in the format of the current presentation.

In September 2011, the FASB amended the guidance on the annual testing of goodwill for impairment. The amended guidance will allow companies to assess qualitative factors to determine if it is more-likely-than-not that goodwill might be impaired and whether it is necessary to perform the two-step goodwill impairment test required under current accounting standards. This guidance will be effective for the Company s fiscal year ending December 30, 2012, with early adoption permitted. The Company has determined that this new guidance will not have a material impact on its consolidated financial statements.

(4) Goodwill

Goodwill is tested for impairment annually as of December 31 or more frequently if events occur or circumstances change that would warrant such a review. The December 31, 2010 review of goodwill indicated that goodwill was not impaired. During the third fiscal quarter of 2011, based on a combination of factors, including declines in revenues within the Electronics Group, declines in the overall government defense market and a decline in the Company s market value of equity, the Company concluded that there were sufficient indicators to require Sypris to perform an interim goodwill impairment analysis.

The Company assesses recoverability using a discounted cash flow analysis. The analysis is based upon available information regarding expected future cash flows of each reporting unit discounted at rates consistent with the cost of capital specific to the reporting unit. A growth rate is used to calculate the terminal value of the reporting unit and is added to the present value of the forecasted cash flows. The growth rate is the expected rate at which a reporting unit s cash flow is projected to grow beyond the period covered by the long-range plan. The cash flow analysis requires significant judgment in our evaluation of the business and establishing an appropriate discount rate and terminal value to apply in the calculation. In selecting these and other assumptions for each business, we consider historical performance, forecasted operating results, expected changes in product mix, general market conditions and industry considerations specific to the business. We make significant assumptions and estimates about the extent and timing of future cash flows, growth rates and discount rates. The cash flows are estimated over a future period of time, which makes those estimates and assumptions inherently subject to a high degree of potential uncertainty. The sum of the calculated fair values of each reporting unit is then reconciled and compared to our total market capitalization, allowing for a reasonable control premium. If the discounted cash flow analysis yields a fair value estimate less than the reporting unit s carrying value, we proceed to step two of the impairment process. In the second step, the implied fair value of the reporting unit s goodwill is determined by allocating the reporting unit s fair value to all of the assets and liabilities of the reporting unit.

As a result of the first step of the goodwill impairment analysis performed as of October 2, 2011, the fair value estimate for the Electronics Group, which is the only remaining reporting unit with goodwill, exceeded its carrying value by approximately 5%. Therefore the second step was not necessary. Key assumptions used to determine the fair value estimate of our Electronics Group during the fourth quarter were the expected after-tax cash flows for the period from 2012 to 2014, which include projected improvements in operating margins, a terminal growth rate of 3.0% and a weighted average cost of capital of 16.7%. The terminal rate is consistent with the prior year growth rate of 3.0%. Our analysis included a comparison of our market capitalization to the fair value of the entire enterprise. These and other estimates and assumptions are impacted by economic conditions and expectations of management and may change in the future based on period-specific facts and circumstances

We believe that the assumptions and estimates used to determine the fair value of our reporting unit were reasonable. However, different assumptions could materially affect the results. If the Electronics Group s future cash flows are different than those projected by management, future impairment charges may be required. The Company will continue to monitor the performance of the Electronics Group, the performance of the overall aerospace and defense industry and the Company s market capitalization.

(5) Discontinued Operations

On October 26, 2009, the Company sold all of the stock of its wholly owned subsidiary, Sypris Test & Measurement, Inc. for $39,000,000, of which $3,000,000 was deposited in an escrow account in connection with certain customary representations, warranties, covenants and indemnifications of the Company. During 2010, the Company was made aware of a potential indemnification claim from the purchaser of Sypris Test & Measurement. The Company estimates that its total liability arising from this claim will not exceed $946,000, of which $450,000 was recorded during the first nine months of 2011. The Company has paid $196,000 related to the claim as of October 2, 2011. The remaining amount has been reserved in accrued liabilities on the Company s consolidated balance sheets. There can be no assurance that similar potential claims will not emerge in the future or that relevant facts and circumstances will not change, necessitating future changes to the estimated liability. This charge is included in loss from discontinued operations, net of tax in the consolidated statement of operations.

(6) Nonrecurring Income

During the nine months ended October 2, 2011, the Company recognized a gain of $3,000,000 in connection with a settlement regarding prior year volumes with one of its customers.

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(7) Other income, net

During the three and nine months ended October 2, 2011, the Company recognized gains of $3,561,000 and $3,620,000, respectively primarily related to the disposition of idle assets. Additionally, the Company recognized foreign currency translation gains of $2,811,000 and $2,128,000 for the three and nine months ended October 2, 2011, respectively, related to the net U.S. dollar denominated monetary asset position of our Mexican subsidiary for which the Mexican peso is the functional currency. These gains are included in other income, net on the consolidated statements of operations.

(8) Restructuring, Impairments and Other Nonrecurring Charges

As announced during the fourth quarter of 2008, the Company committed to a restructuring program, which included the closure of its Kenton, Ohio facility, significant reductions in the workforce in its Marion, Ohio facility and the integration of its Electronics Group subsidiaries. The purpose of the restructuring program is to reduce fixed costs, accelerate integration efficiencies, exit certain unprofitable product lines and significantly improve operating earnings on a sustained basis. As a result of the restructuring program, the Company recorded a charge of $356,000 and $233,000 for the three and nine months ended October 2, 2011, respectively, which are included in restructuring expense, net on the consolidated statement of operations. Of the $356,000 charge recorded in the third quarter of 2011, $342,000 was for equipment relocation costs and $206,000 represented other costs, primarily related to mothball costs associated with closed or partially closed facilities. Partially offsetting this was a $192,000 gain on the sale of assets that had previously been impaired. The charge of $233,000 for the nine months ended October 2, 2011 consisted of equipment relocation costs and mothball costs partially offset by a $685,000 gain on the sale of assets that had previously been impaired.

A summary of the pre-tax restructuring charges is as follows (in thousands):

		Costs Incurred		
	Total Program	Nine Months Ended October 2, 2011	Total Recognized to date	Remaining Costs to be Recognized
Severance and benefit-related costs	$ 4,046	$	$ 4,046	$
Asset impairments	12,836	(685)	12,836	
Deferred contract costs write-offs	17,798		17,798	
Inventory related charges	7,895		7,895	
Equipment relocation costs	2,741	527	2,618	123
Asset retirement obligations	1,501		1,501	
Contract termination costs	3,209		3,209	
Other	5,459	391	5,408	51
	$ 55,485	$ 233	$ 55,311	$ 174

A summary of restructuring activity and related reserves at October 2, 2011 is as follows (in thousands):

	Accrued Balance at December 31, 2010	2011 Charge	Gross Cash Payments	Accrued Balance at October 2, 2011
Severance and benefit-related costs	$ 267	$	$ (84)	$ 183
Asset impairments		(685)	685	
Equipment relocation costs		527	(527)	
Asset retirement obligations	1,173		(447)	726
Contract termination costs	459		(357)	102
Other		391	(391)	

	$ 1,899	$ 233	$ (1,121)	$ 1,011

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A summary of total expenses recognized to date by reportable segment is as follows (in thousands):

	Industrial Group	Electronics Group	Total
Severance and benefit-related costs	$ 2,562	$ 1,484	$ 4,046
Asset impairments	12,836		12,836
Deferred contract costs write-offs		17,798	17,798
Inventory related charges		7,895	7,895
Equipment relocation costs	2,596	22	2,618
Asset retirement obligations	1,501		1,501
Contract termination costs	1,868	1,341	3,209
Other	1,777	3,631	5,408
	$ 23,140	$ 32,171	$ 55,311

The total pre-tax costs of $55,485,000 expected to be incurred includes $23,314,000 within the Industrial Group and $32,171,000 within the Electronics Group. The Company expects to incur additional pre-tax costs of $174,000, all within the Industrial Group.

(9) Dana Claim

On March 3, 2006, the Company s largest customer, Dana Corporation (Dana), and 40 of its U.S. subsidiaries, filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York. On August 7, 2007, the Company entered into a comprehensive settlement agreement with Dana (the Settlement Agreement) to resolve all outstanding disputes between the parties, terminate previously approved arbitration payments and replace three existing supply agreements with a single, revised contract running through 2014. In addition, Dana provided the Company with an allowed general unsecured non-priority claim in the face amount of $89,900,000 (the Claim).

The Claim provided to Sypris was agreed to by Sypris and Dana as consideration for the aggregate economic impact of the various elements the two parties were negotiating. After the aggregate Claim value of $89,900,000 was established, Sypris recorded the claim at the estimated fair value of $76,483,000 and allocated the estimated fair value to each commercial issue negotiated. The revenues and resulting net income associated with each of those issues requiring the Company s continued involvement was deferred and will be recognized over the applicable period of the involvement. For the nine months ended October 2, 2011 and October 3, 2010, the Company recognized into revenue $5,163,000 and $4,584,000, respectively, related to the Claim.

On August 31, 2011, the Company received 143,966 shares of Dana common stock, representing the final distribution to be received in conjunction with the settlement. At October 2, 2011, the cost basis and fair value of the Company s holdings of Dana common stock amounted to $64,000 and $1,512,000, respectively. In accordance with ASC 320-10-25, the $1,448,000 increase in value was recorded as an unrealized holding gain in other comprehensive loss for the three and nine months ended October 2, 2011.

(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 1,097,000 and 654,000 potential common shares excluded from diluted earnings per share for the three and nine months ended October 2, 2011, respectively, because the effect of inclusion would be anti-dilutive.

A reconciliation of the weighted average shares outstanding used in the calculation of basic and diluted earnings (loss) per common share is as follows (in thousands):

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	Three Months Ended		Nine Months Ended	
	October 2, 2011	October 3, 2010	October 2, 2011	October 3, 2010
	(Unaudited)		(Unaudited)	
Earnings attributable to stockholders:				
Income (loss) from continuing operations attributable to stockholders	$ 6,082	$ (1,695)	$ 7,034	$ (8,083)
Discontinued operations, net of tax	0	(196)	(450)	(496)
Net income (loss)	6,082	(1,891)	6,584	(8,579)
Less distributed and undistributed earnings allocable to restricted award holders	(336)	0	(325)	0
Net income (loss) allocable to common stockholders	$ 5,746	$ (1,891)	$ 6,259	$ (8,579)
Basic earnings (loss) per common share attributable to stockholders:				
Continuing operations	$ 0.30	$ (0.09)	$ 0.35	$ (0.43)
Discontinued operations	0.00	(0.01)	(0.02)	(0.03)
Net income (loss)	$ 0.30	$ (0.10)	$ 0.33	$ (0.46)
Diluted earnings (loss) per common share attributable to stockholders:				
Continuing operations	$ 0.30	$ (0.09)	$ 0.35	$ (0.43)
Discontinued operations	0.00	(0.01)	(0.02)	(0.03)
Net income (loss)	$ 0.30	$ (0.10)	$ 0.33	$ (0.46)
Weighted average shares outstanding-basic	18,844	18,628	18,813	18,596
Weighted average additional shares assuming conversion of potential common shares	180	0	186	0
Weighted average shares outstanding-diluted	19,024	18,628	18,999	18,596

(11) Investment in Marketable Securities

The Company s investment in marketable securities consists exclusively of shares in Dana common stock. The Company s investment in Dana common stock is classified as an available-for-sale security in accordance with ASC 320-10-25 and measured at fair value as determined by a quoted market price (a level 1 valuation under ASC 820-10). The related unrealized holding gains are excluded from operations and recorded in accumulated other comprehensive loss on the consolidated balance sheets. At October 2, 2011, the Company owned 143,966 common shares of Dana with a market value of $10.50 per share. At October 2, 2011, the gross unrealized gain was approximately $1,448,000. There were no unrealized gains or losses at December 31, 2010. Realized gains and losses and declines in value judged to be other-than-temporary will be included in other income or expense, if and when recorded. In accordance with ASC 820-10, the fair value of the shares was valued based on quoted market prices in active markets for identical shares at October 2, 2011.

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The following table summarizes marketable securities as of October 2, 2011 (in thousands):

	Basis	Gross Unrealized Gain/(Loss)	Gross Realized Gain/(Loss)	Fair Value At Quoted Prices in Active Markets (Level 1)
Marketable securities	$ 64	$ 1,448	$	$ 1,512

(12) Inventory

Inventory consisted of the following (in thousands):

	October 2, 2011 (Unaudited)	December 31, 2010
Raw materials	$ 6,345	$ 4,758
Work in process	8,060	6,171
Finished goods	3,745	3,729
Costs relating to long-term contracts and programs	19,014	16,431
Reserve for excess and obsolete inventory	(1,118)	(825)
	$ 36,046	$ 30,264

(13) Debt

Debt consisted of the following (in thousands):

	October 2, 2011 (Unaudited)	December 31, 2010
Credit Facility	$ 12,500	$ 0
Former Revolving Credit Agreement	0	10,000
Former Senior Notes	0	13,305
	12,500	23,305
Less current portion	0	2,000
	$ 12,500	$ 21,305

On May 12, 2011, the Company entered into a new credit facility (Credit Facility) providing total availability up to $50,000,000 that supports short-term funding needs and letters of credit, which replaced the Company s Revolving Credit Agreement and Senior Notes scheduled to expire in January 2012. Loans made under the Credit Facility will mature and the commitments thereunder will terminate in May 2016. The Credit Facility provides for an option, subject to certain conditions, to increase total availability to $60,000,000 in the future. Borrowing availability under the Credit Facility is determined by a monthly borrowing base collateral calculation that is based on specified percentages of the value of eligible accounts receivable, inventory and machinery and equipment, less certain reserves and subject to certain other adjustments.

Obligations under the Credit Facility are guaranteed by all of our U.S. subsidiaries and are secured by a first priority lien on substantially all domestic assets of the Company.

The Credit Facility contains a number of covenants that, among other things, limit or restrict our ability to dispose of assets, incur additional indebtedness, incur guarantee obligations, engage in sale and leaseback transactions, prepay other indebtedness, modify organizational documents and certain other agreements, create restrictions affecting subsidiaries, make dividends and other restricted payments, create liens, make investments, make acquisitions, engage in mergers, change the nature of our business and engage in certain transactions with affiliates.

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(14) Segment Data

The Company is organized into two business groups, the Industrial Group and the Electronics Group. The segments are each managed separately because of the distinctions between products, services, markets, customers, technologies and workforce skills of the segments. The Industrial Group provides manufacturing services for a variety of customers that outsource forged and finished steel components and subassemblies. The Industrial Group also manufactures high-pressure closures and other fabricated products. The Electronics Group provides manufacturing and technical services as an outsourced service provider and manufactures assurance products, including link encryptors, data recording products and electronic key fill devices. There was no intersegment net revenue recognized in any of the periods presented.

The following table presents financial information for the reportable segments of the Company (in thousands):

	Three Months Ended		Nine Months Ended	
	October 2, 2011	October 3, 2010	October 2, 2011	October 3, 2010
	(Unaudited)		(Unaudited)	
Net revenue from unaffiliated customers:				
Industrial Group	$ 72,647	$ 52,738	$ 201,082	$ 143,415
Electronics Group	18,530	20,674	50,963	56,006
	$ 91,177	$ 73,412	$ 252,045	$ 199,421
Gross profit:				
Industrial Group	$ 6,931	$ 2,334	$ 19,143	$ 7,073
Electronics Group	3,332	4,891	7,379	10,512
	$ 10,263	$ 7,225	$ 26,522	$ 17,585
Operating income (loss):				
Industrial Group	$ 4,167	$ (54)	$ 14,816	$ (415)
Electronics Group	(342)	1,319	(2,655)	1,010
General, corporate and other	(2,271)	(2,068)	(6,494)	(6,054)
	$ 1,554	$ (803)	$ 5,667	$ (5,459)

(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 balance sheets, as of October 2, 2011 and December 31, 2010 was $951,000 and $866,000, respectively. The Company s warranty expense for the nine months ended October 2, 2011 and October 3, 2010 was $226,000 and $388,000, respectively.

Additionally, the Company sells three and five-year extended warranties for one of its link encryption products. The revenue from the extended warranties is deferred and recognized ratably over the contractual term. As of October 2, 2011 and December 31, 2010, the Company had deferred $2,421,000 and $2,076,000, respectively, related to extended warranties.

The Company bears insurance risk as a member of a group captive insurance entity for certain general liability, automobile and workers compensation insurance programs and a self-insured employee health program. The Company records estimated liabilities for its insurance programs based on information provided by the third-party plan administrators, historical claims experience, expected costs of claims incurred but not paid, and expected costs to settle unpaid claims. The Company monitors its estimated insurance-related liabilities on a quarterly basis. As facts change, it may become necessary to make adjustments that could be material to the Company s consolidated results of operations and financial condition. The Company believes that its present insurance coverage and level of accrued liabilities are adequate.

The Company is involved in certain litigation and contract issues arising in the normal course of business. While the outcome of these matters cannot, at this time, be predicted in light of the uncertainties inherent therein, management does not expect that these matters will have a material adverse effect on the consolidated financial position or results of operations of the Company.

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As of October 2, 2011, the Company had outstanding purchase commitments of approximately $11,179,000, primarily for the acquisition of inventory and manufacturing equipment. As of October 2, 2011, the Company also had outstanding letters of credit of $990,000 primarily under the aforementioned captive insurance program.

(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 35% and for its foreign operations at a statutory rate of 30% in 2011 and 2010. The Company s foreign operations are also subject to minimum income taxes in periods where positive cash flows exceed taxable income. Reconciling items between the federal statutory rate and the effective tax rate also include 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 basis of assets or liabilities and their reported amounts in the financial statements in accordance with ASC 740, *Income Taxes*. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of assets or liabilities are recovered or settled. ASC 740 requires that a valuation allowance be established when it is more likely than not that all or a portion of a deferred tax asset will not be realized. The Company evaluates its deferred tax position on a quarterly basis and valuation allowances are provided as necessary. During this evaluation, the Company reviews its forecast of income in conjunction with other positive and negative evidence surrounding the realizability of its deferred tax assets to determine if a valuation allowance is needed. Based on the current forecast, the Company has established a valuation allowance against the domestic net deferred tax asset. Until an appropriate level and characterization of profitability is attained, the Company expects to continue to maintain a valuation allowance on its net deferred tax assets related to future U.S. and certain non-U.S. tax benefits.

(17) Employee Benefit Plans

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

	Three Months Ended		Nine Months Ended	
	October 2, 2011	October 3, 2010	October 2, 2011	October 3, 2010
	(Unaudited)		(Unaudited)	
Service cost	$ 9	$ 2	$ 27	$ 33
Interest cost on projected benefit obligation	517	516	1,551	1,653
Net amortizations, deferrals and other costs	146	111	439	399
Expected return on plan assets	(638)	(654)	(1,915)	(1,946)
	$ 34	$ (25)	$ 102	$ 139

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(18) Other Comprehensive Income (Loss)

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

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

	Three Months Ended		Nine Months Ended	
	October 2, 2011	October 3, 2010	October 2, 2011	October 3, 2010
	(Unaudited)		(Unaudited)	
Net income (loss)	$ 6,082	$ (1,891)	$ 6,584	$ (8,579)
Other comprehensive income (loss):				
Unrealized gain on available-for-sale securities	1,448	0	1,448	0
Foreign currency translation adjustments	(6,171)	1,414	(3,865)	1,518
Total comprehensive income (loss)	$ 1,359	$ (477)	$ 4,167	$ (7,061)

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

	October 2, 2011 (Unaudited)	December 31, 2010
Foreign currency translation adjustments	$ (5,809)	$ (1,944)
Unrealized gain on available-for-sale securities, net of tax	1,448	0
Employee benefit-related adjustments, net of tax of $2,512 U.S	(11,889)	(11,889)
Employee benefit-related adjustments Mexico	(491)	(491)
Accumulated other comprehensive loss	$ (16,741)	$ (14,324)

(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 October 2, 2011 under the Credit Facility approximates fair value because borrowings are for terms of less than six months and have rates that reflect currently available terms and conditions for similar debt.

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

Overview

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

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

During the past three years, we have significantly improved our financial condition by reducing fixed costs, accelerating integration efficiencies, exiting certain unprofitable product lines, reducing debt and entering into a new, more favorable debt facility.

While the commercial vehicle and trailer markets continue to rebound from historic lows within our Industrial Group, we continue to face challenges within our Electronics Group, such as the uncertainty in the worldwide macroeconomic climate and its impact on aerospace and defense spending patterns globally, as well as federal government spending in the U.S.

The U.S. Government's continued focus on addressing federal budget deficits and the growing national debt suggests a changing environment for the Electronics Group. Although defense spending is expected to remain a national priority within the federal budget, a fiscally constrained environment could prompt the government to seek additional deficit reduction by moderating discretionary spending, of which defense constitutes the majority share.

The Administration and Congress are engaged in vigorous discussion over alternative approaches to reduce the federal deficit and curtail spending. Some revision to current national security spending could emerge in forthcoming budget plans and appropriations as these negotiations continue. There can be no assurance at this time regarding when and how this matter will be resolved or its effects on the overall U.S. economy or federal budgets. In this context, the Department of Defense is currently conducting a strategic review intended to guide its budgeting decisions. Our Company awaits the results of this review, as well as the outcomes of the broader federal budget discussion, as these decisions are expected to shape planning directions across the industry.

Results of Operations

We operate in two business segments, the Industrial Group and the Electronics Group. The tables presented below, which compare our segment and consolidated results for the three and nine month periods of operations of 2011 to 2010, present the results for each period, the change in those results from 2011 to 2010 in both dollars and percentage change and the results for each period as a percentage of net revenue.

The first two data 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.

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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 October 2, 2011 Compared to Three Months Ended October 3, 2010

	Three Months Ended October 2, 2011	Three Months Ended October 3, 2010	Year Over Year Change Favorable (Unfavorable)	Year Over Year Percentage Change Favorable (Unfavorable)	Results as Percentage of Net Revenue for the Three Months Ended October 2, 2011	Results as Percentage of Net Revenue for the Three Months Ended October 3, 2010
			(in thousands, except percentage data)			
Net revenue:						
Industrial Group	$ 72,647	$ 52,738	$ 19,909	37.8%	79.7%	71.8%
Electronics Group	18,530	20,674	(2,144)	(10.4)	20.3	28.2
Total	91,177	73,412	17,765	24.2	100.0	100.0
Cost of sales:						
Industrial Group	65,716	50,404	(15,312)	(30.4)	*90.5*	*95.6*
Electronics Group	15,198	15,783	585	3.7	*82.0*	*76.3*
Total	80,914	66,187	(14,727)	(22.3)	88.7	90.2
Gross profit:						
Industrial Group	6,931	2,334	4,597	197.0	*9.5*	*4.4*
Electronics Group	3,332	4,891	(1,559)	(31.9)	*18.0*	*23.7*
Total	10,263	7,225	3,038			