SYPRIS SOLUTIONS INC
Form 10-K
March 11, 2014
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark one)

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. For the fiscal year ended December 31, 2013.
Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. For the transition period from ________ to ________.

Commission file number 0-24020

SYPRIS SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**61-1321992**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

101 Bullitt Lane, Suite 450	
Louisville, Kentucky 40222	**(502) 329-2000**
(Address of principal executive offices, including zip code)	(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

(Title of each class)	**(Name of each exchange on which registered)**
Common Stock, $.01 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2013) was $33,905,599.

There were 20,377,418 shares of the registrant's common stock outstanding as of March 4, 2014.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to stockholders in connection with the Annual Meeting of Stockholders to be held April 29, 2014 are incorporated by reference into Part III to the extent described therein.

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In this Annual Report on Form 10-K, “Sypris,” “the Company,” “we,” “us” and “our” refer to Sypris Solutions, Inc. and its subsidiaries and predecessors, collectively. “Sypris Solutions” and “Sypris” are our trademarks. All other trademarks, servicemarks or trade names referred to in this Annual Report on Form 10-K are the property of their respective owners.

PART I

Item 1. Business

General

We were formed as a Delaware corporation in 1997. 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 sole-source contracts with corporations and government agencies principally in the markets for industrial manufacturing and aerospace and defense electronics.

We are organized into two business groups, the Industrial Group and the Electronics Group. The Industrial Group, which is comprised of Sypris Technologies, Inc. and its subsidiaries, generates revenue primarily from the sale of manufacturing services to customers in the market for truck components and assemblies and from the sale of products to the energy and chemical markets. The Electronics Group, which is comprised of Sypris Electronics, LLC and its subsidiary, generates revenue primarily from the sale of manufacturing services, technical services and products to customers in the market for aerospace and defense electronics.

We focus on those markets where we believe we have the expertise, qualifications and leadership position to sustain a competitive advantage. We target our resources to support the needs of industry participants 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, historically, have been renewed 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.

Industrial Manufacturing Group (the Industrial Group). Through our Industrial Group, we are a significant supplier of forged and machined components, serving the commercial vehicle, off highway vehicle, light truck and energy markets in North America. We produce drive train components including axle shafts, gear sets, differential cases, steer axle forgings, and other components under sole-source contracts with Meritor, Inc. (Meritor) and Dana Holding Corporation (Dana), the two primary providers of drive train assemblies for use by the leading truck manufacturers, including Ford Motor Company (Ford), Freightliner LLC (Freightliner), Mack Trucks, Inc. (Mack), Navistar International Corporation (Navistar), PACCAR, Inc. (PACCAR) and Volvo Truck Corporation (Volvo). We also supply Meritor with trailer axle beams for use by the leading trailer manufacturers, including Great Dane Limited Partnership (Great Dane), Hyundai Motor Company (Hyundai), Stoughton Trailers, LLC (Stoughton), Utility Trailer Manufacturing Company (Utility) and Wabash National Corporation (Wabash). We support our customers' strategies to outsource non-core operations by supplying additional components and providing additional value added operations for drive train assemblies. Over the past several years, we have implemented a restructuring plan that has allowed us to adjust our overhead and infrastructure to be in line with current and projected levels of customer demand and market requirements. The plan has been successful, resulting in significant and permanent cost reductions that have lowered our operating breakeven level. The plan also included a diversification strategy which has resulted in the recent addition of long-term agreements with Eaton Corporation (Eaton) and American Axle & Manufacturing, Inc., under which we supply forgings. We expect to benefit from these actions in the future as global economic conditions and the strength of the commercial vehicle industry continue to improve.

Aerospace & Defense Electronics Group (the Electronics Group). Our Electronics Group is organized around two primary business lines: Information Security Solutions (ISS) and Electronic Manufacturing Services (EMS).

Information Security Solutions (ISS). Our ISS business provides solutions in cyber security, secure communications, global electronic key management, Sypris Data Systems branded products, and product design and development to the U.S. Government, both defense and civilian agencies, international government agencies, as well as worldwide aerospace and defense prime contractors. This group has several contracts with the Department of Defense to design and build information assurance products, including link encryptors, data recording products and electronic key fill devices.

Electronic Manufacturing Services (EMS). Our EMS business is focused on circuit card and full box build manufacturing, dedicated space and high reliability manufacturing, integrated design and engineering services, systems assembly and integration, design for manufacturability, and design to specification work. Our customers include large aerospace and defense companies such as Lockheed Martin Corporation (Lockheed Martin), Northrop Grumman Corporation (Northrop Grumman) and Exelis Inc. (Exelis).

The industry and business environment of our Electronics Group continues to be shaped by policy and budget decisions of the U.S. Government, as well as economic conditions. Recent actions of Congress and the Administration indicate an ongoing emphasis on federal budget deficit reduction. Near-term budget decisions by the Congress and the Administration may considerably reduce discretionary spending, of which defense constitutes the majority share. The Budget Control Act of 2011 (the "Budget Control Act") commits the U.S. Government to reduce the federal deficit by $1.2 trillion over ten years through a combination of automatic, across-the-board spending cuts and caps on discretionary spending. The deficit reduction "sequestration" under the Budget Control Act is split equally between defense and non-defense programs and went into effect on March 1, 2013. However, the Bipartisan Budget Act of 2013 provided some budget relief, reducing the discretionary sequester (and increasing funding) for fiscal year 2014 and fiscal year 2015 for both defense and non-defense programs. Unless Congress passes a similar law providing budget relief beyond fiscal year 2015, the full sequester cuts will go back into effect for fiscal year 2016. In addition, in February 2014, the Pentagon announced that its budget request for fiscal year 2015 would exceed the sequester caps but would be below the funding in the President's fiscal year 2014 budget request. Congress and the Administration continue to debate these long- and short-term funding issues, but reductions in U.S. military spending could materially adversely affect the results of our Electronics Group. Our Electronics Group accounted for approximately 11% of net revenue in 2013.

Our Markets

Industrial Group. The industrial manufacturing markets include truck components and assemblies, trailer components and specialty closures. The truck components and assemblies market consists of the original equipment manufacturers, or OEMs, including Chrysler Group LLC, Ford, Freightliner, General Motors Company, Mack, Navistar, PACCAR and Volvo, and an extensive supply chain of companies of all types and sizes that are classified into different levels or tiers. The trailer market consists of OEMs including Great Dane, Wabash, Utility, Hyundai, Vanguard and Stoughton. Tier I companies represent the primary suppliers to the OEMs and include Meritor, Dana, Delphi Automotive LLP, Eaton and Visteon Corporation, among others. Below this group of companies reside numerous suppliers that either supply the OEMs directly or supply the Tier I companies. In all segments of the truck components and assemblies and the trailer markets, however, suppliers are under intense competitive pressure to improve product quality and to reduce capital expenditures, production costs and inventory levels. The specialty closures market consists primarily of oil and gas pipelines, which are also facing significant pressures to improve quality, reduce costs and defer capital expenditures.

General economic and industry specific conditions have begun to stabilize, and improvements in the overall U.S. economy contributed to improved consumer confidence levels in 2013. In North America, production levels for light, medium and heavy duty trucks have steadily increased over the past four years from a low in the depressed economic environment of 2008 and early 2009. Subject to the renewals of our supply agreements with Dana and Meritor, we continue to expect modest growth in production levels within our Industrial Group through 2014 and 2015.

Electronics Group. As noted above, the U.S. Government continues to focus on developing and implementing spending, tax and other initiatives to reduce the deficit, create jobs and stimulate the economy. This process and the spending reductions to defense programs has adversely impacted our portfolio of business in this segment, which is dependent upon discretionary appropriations for defense programs. Although we believe that our products and programs are well aligned with national defense and other priorities, shifts in domestic and international spending and tax policy, changes in security, defense and intelligence priorities, the affordability of our products and services, changes in or preferences for new or different technologies, general economic conditions and other factors may affect the level of funding for existing or proposed programs. Uncertainty over budget plans and national security spending may prove challenging for our customers, as well as the defense industry as a whole.

Market conditions for our ISS business are expected to be favorable over the long term, given the growing cyber security and intelligence markets. However, market conditions for our EMS business, dedicated to the aerospace and defense market, are characterized by a number of obstacles. The nature of providing outsourced manufacturing services to the aerospace and defense electronics industry differs substantially from the traditional commercial outsourced electronics manufacturing services industry. The cost of failure can be extremely high, the manufacturing requirements are typically complex and products are produced in relatively small quantities. Companies that provide these manufacturing services are required to maintain and adhere to a number of strict and comprehensive certifications, security clearances and traceability standards. As mentioned above, U.S. Government and private customer spending levels remain uncertain.

Our Business Strategy

Our objective is to improve our position in each of our core markets by increasing our number of multi-year contracts with customers and investing in highly automated production capacity to remain competitive on a global scale. We intend to serve our customers and achieve this objective by continuing to:

Concentrate on our Core Markets. We are a significant supplier of forged and machined components, serving the commercial vehicle, off highway vehicle, light truck and energy markets in North America. We have been an established supplier of manufacturing and technical services to major aerospace and defense companies and agencies of the U.S. Government for over 40 years. We will continue to focus on those markets where we have the expertise and qualifications to achieve a competitive advantage.

Dedicate our Resources to Support Strategic Partnerships. We will continue to dedicate our resources to support the needs of industry leaders that embrace multi-year contractual relationships as a strategic component of their supply chain management and have the potential for long-term growth. We prefer contracts that are sole-source by part number so we can work closely with the customer to the mutual benefit of both parties. Dana, Meritor, and Meritor's Brazilian subsidiary have awarded us with sole-source supply agreements for certain parts that run through at least 2014, 2015, and 2016 respectively. During 2013, Sypris and Dana executed an amendment to extend our current sole-source supply agreement until 2020. While Dana has attempted to repudiate this amendment, we are seeking to enforce the amendment through pending arbitration and litigation proceedings (see "Risk Factors – Customer contracts may not be renewed on acceptable terms or at all. Our largest customer Dana has notified us of its intent to terminate our supply relationship." in Part I, Item 1A. of this Annual Report on Form 10-K). Historically, we entered into multi-year manufacturing services agreements with Lockheed Martin, Northrop Grumman and Exelis. Our success in establishing outsourcing partnerships with key customers has historically led to additional contracts, and we believe that if we continue to successfully perform on current contracts, we should have additional growth opportunities with these and other customers.

Pursue the Strategic Acquisition of Assets. Over the long term, we will continue to target the strategic acquisition of assets that serve to consolidate our position in our core markets, expand our presence outside the U.S., create or strengthen our relationships with leading companies and expand our range of value-added services in return for multi-year supply agreements. We intend to acquire assets that can be integrated with our core businesses and that can be used to support other customers, thereby improving asset utilization and achieving greater productivity, flexibility and economies of scale.

Grow Through the Addition of New Value-Added Services. We hope to grow through the addition of new value-added manufacturing capabilities and the introduction of additional components in the supply chain that enable us to provide a more complete solution by improving quality and reducing product cost, inventory levels and cycle times for our customers. In many instances, we offer a variety of state-of-the-art machining capabilities to our customers in the industrial manufacturing markets that enable us to reduce labor and shipping costs and minimize cycle times for our customers over the long-term, providing us with additional growth opportunities in the future. Successfully migrating from design and manufacturing of complex circuit card assemblies to box builds would increase product content with our customers and would allow us to be a more significant player in the aerospace and defense market.

We believe that the number and duration of our strategic relationships enable us to invest in our business with greater certainty and with less risk than others that do not benefit from the type of longer term contractual commitments we receive from many of our major customers. The investments we make in support of these contracts are targeted to provide us with the productivity, flexibility, technological edge and economies of scale that we believe will help to differentiate us from the competition in the future when it comes to cost, quality, reliability and customer service.

Our Services and Products

We are a diversified provider of outsourced services and specialty products. Our services consist of manufacturing, technical and other services and products that are delivered as part of our customers' overall supply chain management. We provide our customers with services that include software licensing and development, design services, prototype development, product re-engineering, feature enhancement, product ruggedization, cost reduction, product miniaturization and electro-magnetic interference and shielding. We also apply our core technologies to the development and production of our own product line of high assurance security components, including cryptographic key management programs and data encryption and recording products for our U.S. Government and defense customers. The information below is representative of the types of products we manufacture, services we provide and the customers and industries for which we provide such products or services.

Industrial Group:

Dana	Drive train components (including axle shafts, differential cases, gear sets, full float tubes) and steer axle components for use in light, medium and heavy-duty trucks.
Meritor	Axle shafts and drive train components for medium and heavy-duty trucks as well as axle beams for trailers.
Eaton	Transmission shafts for heavy-duty trucks.
Jamison Products	Specialty closures for oil and gas pipelines.

Electronics Group:

Northrop Grumman	Circuit card assembly and sub-assembly design and build for electronic sensors and systems ranging from radar and targeting systems to tactical ground stations, navigation systems and integrated avionics.
U.S. Government	Secure communications equipment, global key management solutions and data recording systems.
Lockheed Martin	Complex circuit cards for use in some of the nation's high priority space programs.
Exelis	Complex circuit cards and subassemblies for use in weapons systems, targeting and warning systems.

Manufacturing Services

Our manufacturing services typically involve the fabrication or assembly of a product or subassembly according to specifications provided by our customers. We purchase raw materials or components from our customers and independent suppliers in connection with performing our manufacturing services. We strive to enhance our manufacturing capabilities by advanced quality and manufacturing techniques, lean manufacturing, just-in-time procurement and continuous flow manufacturing, six sigma, total quality management, stringent and real-time engineering change control routines and total cycle time reduction techniques.

Industrial Manufacturing Services. We provide our customers with a wide range of capabilities, including automated forging, extruding, machining, induction hardening, heat-treating and testing services to meet the exacting requirements. We also design and fabricate production tooling, manufacture prototype products and provide other value-added services for our customers. Our manufacturing services contracts for the truck components and assemblies markets are generally sole-source by part number. Part numbers may be specified for inclusion in a single model or a range of models. Where we are the sole-source provider by part number, we are the exclusive provider to our customer of the specific parts and for any replacements for these parts that may result from a design or model change for the duration of the manufacturing contract.

Electronics Manufacturing Services. We provide our customers with a broad variety of value added solutions, from low-volume prototype assembly to high-volume turnkey manufacturing. We employ a multi-disciplined engineering team that provides comprehensive manufacturing and design support to customers. The manufacturing solutions we offer include design conversion and enhancement, process and tooling development, materials procurement, system assembly, testing and final system configuration. Our manufacturing services contracts for the aerospace and defense electronics market are generally sole-source by part number.

Products

In addition to our outsourced services, we provide some of our customers with specialized products including digital and analog data systems and encryption devices used in military applications and specialty closures and joints used in pipeline and chemical systems. As we look to grow our business, emphasis will be placed on the funding of new products to broaden our portfolio and meet the needs of our customers.

Our Customers

Our customers include large, established companies and agencies of the federal government. We provide some customers with a combination of outsourced services and products, while other customers may be in a single category of our service or product offerings. Our five largest customers in 2013 were Dana, Meritor, Sistemas Corporation (Sistemas), Northrop Grumman and Eaton, which in the aggregate accounted for 81% of net revenue. Our five largest customers in 2012 were Dana, Meritor, Sistemas, the Australian government and Eaton, which in the aggregate accounted for 79% of net revenue. In 2013, Dana and Meritor represented approximately 58% and 15% of our net revenue, respectively. In 2012, Dana and Meritor represented approximately 55% and 15% of our net revenue, respectively. In addition, U.S. governmental agencies accounted for 3% and 6% of net revenue in 2013 and 2012, respectively.

Geographic Areas and Currency Fluctuations

We are located in the U.S., Mexico, Denmark and the U.K. Our Mexican subsidiaries and affiliates are a part of our Industrial Group and manufacture and sell a number of products similar to those the Industrial Group produces in the U.S. Our Denmark subsidiary is a sales office and is part of our Electronics Group. Our U.K subsidiary is a sales office and is part of our Industrial Group. In addition to normal business risks, operations outside the U.S. may be subject to a greater risk of changing political, economic and social environments, changing governmental laws and regulations, currency revaluations and market fluctuations. Fluctuations in foreign currency exchange rates have primarily impacted our earnings only to the extent of remeasurement gains or losses related to U.S. dollar denominated accounts of our foreign subsidiaries, because the vast majority of our transactions are denominated in U.S. dollars. For the year ended December 31, 2013, other income, net, included foreign currency transaction losses of $0.3 million. For 2012, other income, net, included foreign currency transaction losses of $0.8 million.

Net revenues from Mexican operations were $95.4 million, or 31%, and $100.0 million, or 29%, of our consolidated net revenues in 2013 and 2012, respectively. In 2013, net income from our Mexican operations was $7.7 million, as compared to our consolidated loss from continuing operations of $9.9 million. In 2012, net income from our Mexican operations was $7.5 million, as compared to our consolidated income from continuing operations of $10.3 million.

You can find more information about our regional operating results, including our export sales, in “Note 20 Segment Information” to our consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

Sales and Business Development

Our principal sources of new business originate from the expansion of existing relationships, referrals and direct sales through senior management, direct sales personnel, domestic and international sales representatives, distributors and market specialists. We supplement these selling efforts with a variety of sales literature, advertising in numerous trade media and participating in trade shows. We also utilize engineering specialists extensively to facilitate the sales process by working with potential customers to reduce the cost of the service they need. Our specialists achieve this objective by working with the customer to improve their product’s design for ease of manufacturing or by reducing the amount of set-up time or material that may be required to produce the product. The award of contracts or programs can be a lengthy process, which in some circumstances can extend well beyond 12 months. Upon occasion, we commit resources to potential contracts or programs that we ultimately do not win.

Our objective is to increase the value of the services we provide to the customer on an annual basis beyond the contractual terms that may be contained in a supply agreement. To achieve this objective, we commit to the customer that we will continuously look for ways to reduce the cost, improve the quality, reduce the cycle time and improve the life span of the products and/or services we supply the customer. Our ability to deliver on this commitment over time is expected to have a significant impact on customer satisfaction, loyalty and follow-on business.

Competition

The markets that we serve are highly competitive, and we compete against numerous domestic companies in addition to the internal capabilities of some of our customers. In the truck components and assemblies market, we compete primarily against other component suppliers such as Mid-West Forge, Inc., Spencer Forge and Machine, Inc. and Traxle, which serve as suppliers to many Tier I and smaller companies. In the aerospace and defense electronics market, we compete primarily against companies such as Celestica Inc., Jabil Circuit, Inc., LaBarge, Inc. and Safenet, Inc. We may face new competitors in the future as the outsourcing industry evolves and existing or start-up companies develop capabilities similar to ours. In addition, we will face new competitors as we attempt to increase and expand our business.

We believe that the principal competitive factors in our markets include the availability of capacity, technological capability, flexibility, financial strength and timeliness in responding to design and schedule changes, price, quality and delivery. Although we believe that we generally compete favorably with respect to each of these factors, some of our competitors, as compared to us, are larger and have greater financial and operating resources, greater geographic breadth and range of services, customer bases and brand recognition than we do. We also face competition from manufacturing operations of our current and potential customers that continually evaluate the relative benefits of internal manufacturing compared to outsourcing.

Suppliers

For significant portions of our business, we purchase raw materials and component parts from our customers or from suppliers chosen by our customers, at prices negotiated by our customers. When these suppliers increase their prices, cause delays in production schedules or fail to meet our customers’ quality standards, our customers have contractually agreed to reimburse us for the costs associated with such price increases and not to charge us for costs caused by such delays or quality issues. Accordingly, our risks are largely limited to accurate inspections of such materials, timely communications and the collection of such reimbursements or charges, along with any additional costs incurred by us due to delays in, interruptions of, or non-optimal scheduling of production schedules. However, for a growing part of our business, we arrange our own suppliers and assume the additional risks of price increases, quality concerns and production delays.

Raw steel and fabricated steel parts are a major component of our cost of sales and net revenue for the truck components and assemblies business. We purchase a significant portion of our steel for use in this business at the direction of our customers, with any periodic changes in the price of steel being reflected in the prices we are paid for our services. Increases in the costs of steel or other supplies can increase our working capital requirements, scrap expenses and borrowing costs.

There can be no assurance that supply interruptions or price increases will not slow production, delay shipments to our customers or increase costs in the future, any of which could adversely affect our financial results. Delays, interruptions or non-optimal scheduling of production related to interruptions in raw materials supplies can be expected to increase our costs.

Research and Development

Our research and development activities are mainly related to our product lines that serve the aerospace and defense electronics market. Process improvement expenditures related to our outsourced services are not reflected in research and development expense. Accordingly, our research and development expense represents a relatively small percentage of our net revenue. Company-sponsored research and development costs are expensed as incurred. We invested $3.0 million and $3.8 million in research and development in 2013 and 2012, respectively. Customer-sponsored research and development costs are incurred under U.S. Government-sponsored contracts and require us to provide a product or service meeting certain defined performance or other specifications (such as designs). Customer-sponsored research and development is accounted for under the milestone method and included in our net revenue and cost of sales (see Critical Accounting Policies and Estimates in Item 7 of this Annual Report on Form 10-K).

Patents, Trademarks and Licenses

We own or license a number of patents and trademarks, but our business as a whole is not materially dependent upon any one patent, trademark, license or technologically related group of patents or licenses.

We regard our manufacturing processes and certain designs as proprietary trade secrets and confidential information. We rely largely upon a combination of trade secret laws, non-disclosure agreements with customers, suppliers and consultants, and our internal security systems, confidentiality procedures and employee confidentiality agreements to maintain the trade secrecy of our designs and manufacturing processes.

Government Regulation

Our operations are subject to compliance with regulatory requirements of federal, state and local authorities, in the U.S., the U.K., Denmark and Mexico, including regulations concerning financial reporting and controls, labor relations, minimum pension funding levels, export and import matters, health and safety matters and protection of the environment. While compliance with applicable regulations has not adversely affected our operations in the past, there can be no assurance that we will continue to be in compliance in the future or that these regulations will not change or that the costs of compliance will not be material to us.

We must comply with detailed government procurement and contracting regulations and with U.S. Government security regulations, certain of which carry substantial penalty provisions for nonperformance or misrepresentation in the course of negotiations. Our failure to comply with our government procurement, contracting or security obligations could result in penalties or our suspension or debarment from government contracting, which would have a material adverse effect on our consolidated results of operations.

We are required to maintain U.S. Government security clearances in connection with certain activities of our Electronics Group. These clearances could be suspended or revoked if we were found not to be in compliance with applicable security regulations. Any such revocation or suspension would delay our delivery of products to customers. Although we have adopted policies directed at ensuring our compliance with applicable regulations, and there have been no suspensions or revocations at our facilities, there can be no assurance that the approved status of our facilities or personnel will continue without interruption.

We are also subject to comprehensive and changing federal, state and local environmental requirements, both in the U.S. and in Mexico, including those governing discharges to air and water, the handling and disposal of solid and hazardous wastes and the remediation of contamination associated with releases of hazardous substances. We use hazardous substances in our operations and, as is the case with manufacturers in general, if a release of hazardous substances occurs on or from any properties that we may own or operate, we may be held liable and may be required to pay the cost of remedying the condition. The amount of any resulting liability could be material.

Employees

As of December 31, 2013, we had a total of 1,181 employees, of which 898 are engaged in manufacturing and providing our technical services, 17 are engaged in sales and marketing, 118 are engaged in engineering and 148 are engaged in administration. Approximately 500 of our employees are covered by collective bargaining agreements with various unions that expire on various dates through 2016. Excluding certain Mexico employees covered under an annually ratified agreement, collective bargaining agreements covering 149 employees expire within the next 12 months. Although we believe overall that relations with our labor unions are positive, there can be no assurance that present and future issues with our unions will be resolved favorably, that negotiations will be successful or that we will not experience a work stoppage, which could adversely affect our consolidated results of operations.

Internet Access

Copies of our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge through our website (www.sypris.com) as soon as reasonably practicable after we electronically file the material with, or furnish it to, the Securities and Exchange Commission.

Item 1A. Risk Factors

Risks Related to Our Business and Forward-Looking Statements

This annual report 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 industries, business strategies, the markets in which we operate, potential acquisitions, contracts with customers, new business opportunities or financial results and our views about developments beyond our control including government spending, domestic or global economic conditions, trends and market forces. These statements are based on management’s views and assumptions at the time originally made, and we undertake no obligation to update these statements, except as may be required by law. There can be no assurance that our expectations, projections or views will come to pass, and you should not place undue reliance on these forward-looking statements.

A number of significant risk 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, including those described below. Many of these risk factors are also identified in connection with the more specific descriptions contained throughout this report.

Customers

We need to generate new business revenues supported by a sustainable competitive advantage.

Our businesses generally require a higher level of new business revenues in order to operate profitably. Unless we can develop and offer new products and services with a sustainable competitive advantage, we may be unable to maintain the critical mass of capital investments or talented employees that are needed to succeed in our chosen markets. In the truck components and assemblies markets, our revenues are highly dependent upon the overall demand for new vehicles. In the aerospace and defense markets, our revenues are highly dependent upon new product development (especially in our cybersecurity programs), effective marketing and sales activities, the development of additional profitable capacity (especially in our space engineering programs) and the profitable management of our legacy products and services.

Customer contracts may not be renewed on acceptable terms or at all. Our largest customer Dana has notified us of its intent to terminate our supply relationship.

Our two largest customers, Dana and Meritor, have contracts with expiration dates of December 31, 2014 and, for a portion of the Meritor goods, May 2, 2015. In 2013, Dana and Meritor represented approximately 58% and 15% of our revenues. While we have executed an extension of the Dana contract extending until 2020, Dana is attempting to repudiate that extension. We may not be able to enforce or renew either or both these agreements on acceptable terms or at all. The failure to do so or otherwise maintain our current levels of work from both of these customers would have a material adverse effect on our financial condition and financial performance.

We are in the process of negotiating with Dana to attempt to continue our long-standing relationship as one of its suppliers. We have also been in litigation over the validity of the amended and restated supply agreement that Dana and Sypris entered into in July, 2013. The failure to resolve the ongoing dispute with Dana on acceptable terms, to succeed in enforcing the extended agreement, or to enter into a new or replacement agreement with Dana on acceptable terms would have a material adverse effect on our financial condition and financial performance.

Customer contracts could be less profitable than expected.

We generally bear the risk that our contracts could be unprofitable or less profitable than planned, despite our estimates of revenues and future costs to complete such contracts.

A material portion of our business, historically, has been conducted under multi-year contracts, which generally include fixed prices or periodic price reductions without minimum purchase requirements. Over time, our revenues may not cover our increasing operating costs which could adversely impact our results. Our financial results are at greater risk when we accept contractual responsibility for raw material or component prices, when we cannot offset price reductions and cost increases with operating efficiencies or other savings, when we must submit contract bid prices before all key design elements are finalized or when we are subjected to other competitive pressures which erode our margins. The profitability of our contracts also can be adversely affected by unexpected start-up costs on new programs, operating inefficiencies, ineffective capital investments, inflationary pressures or inaccurate forecasts of future unit costs.

In the past, we have signed long-term supply agreements with Dana and Meritor and acquired their facilities in Morganton, North Carolina and Toluca, Mexico, among other manufacturing assets. Although most of these acquired facilities have well-established product markets, these customers or their products may not continue to be successful, product enhancements may not be made in a timely fashion, and any long-term pricing agreements could generate lower margins than anticipated. If these facilities are required to operate at underutilized levels, it could materially adversely affect our business, results of operations and financial condition.

Unexpected changes in our customers' demand levels have harmed our operating results in the past and could do so in the future. Many of our customers will not commit to firm production or delivery schedules. Disagreements over pricing, quality, delivery, capacity, exclusivity or trade credit terms could disrupt order schedules. Orders may also fluctuate due to changing global capacity and demand, new products, changes in market share, reorganizations or bankruptcies, material shortages, labor disputes or other factors that discourage outsourcing. These forces could increase, decrease, accelerate, delay or cancel our delivery schedules.

Inaccurate forecasting of our customers' requirements can disrupt the efficient utilization of our manufacturing capacity, inventories or workforce. If we lose anticipated revenues, we might not succeed in redeploying our substantial capital investment and other fixed costs, potentially forcing additional plant closures, impairments of long-lived and other assets or increased losses. If we receive unanticipated orders or rapid increases in demand, these incremental volumes could be unprofitable due to the higher costs of operating above our optimal capacity.

We depend on a few key customers in challenging industries for most of our revenues.

Our five largest customers in 2013 were Dana, Meritor, Sistemas, Northrop Grumman and Eaton, collectively accounting for 81% of net revenue. Our five largest customers in 2012 were Dana, Meritor, Sistemas, the Australian government and Eaton, collectively accounting for 79% of net revenue. In addition, U.S. governmental agencies accounted for 3% and 6% of net revenue in 2013 and 2012, respectively. The truck components and assemblies industry has experienced credit risk, highly cyclical market demand, labor unrest, rising steel costs, bankruptcy and other obstacles, while the aerospace and defense electronics industry has experienced consolidation, increased competition, disruptive new technologies and uncertain funding.

We depend on the continued growth and financial stability of these customers and our core markets, as well as general economic conditions. Adverse changes affecting these customers, markets or economic conditions could harm our operating results. The truck components and assemblies market is highly cyclical, due in part to regulatory deadlines, the availability or scarcity of credit, fluctuations in oil prices and pent-up demand for replacement vehicles.

Rising costs of steel or component parts could increase our inventory and working capital levels and present challenges to our customers who seek to pass those costs on to their customers. Many of our customers’ labor disputes, financial difficulties and restructuring needs have created rising uncertainty and risk, which could increase our costs or impair our business model.

The aerospace and defense industry is pressured by cyclicality, rapid technological change, shortening product life cycles, decreasing margins, unpredictable funding levels and government procurement and certification processes. Our aerospace and defense business faces an aging portfolio of legacy products and services which must be replenished with new technologies if we are to successfully maintain or expand our market share. Our failure to address any of these factors, particularly in our secured electronic communications or space engineering programs, could impair our business model.

There can be no assurance that any of our customers will not default on, delay or dispute payment of, or seek to reject our outstanding invoices in bankruptcy or otherwise.

Congressional budgetary constraints or reallocations could reduce our government sales.

Our Electronics Group sells manufacturing services and products to a number of U.S. government agencies, which in the aggregate represented approximately 3% and 6% of our net revenue in 2013 and 2012, respectively. We also serve as a contractor for large aerospace and defense companies such as Lockheed Martin, Northrop Grumman and Exelis, typically under federally funded programs, which represented approximately 5% and 4% of net revenue in 2013 and 2012, respectively.

Our government contracts have many inherent risks that could adversely impact our financial results. These contracts depend upon the continuing availability of Congressional appropriations. The budget appropriations process in Congress has at times become highly politicized and unpredictable, including the growing use of “continuing resolutions” as a temporary approach to the resolution of disputes over funding levels. In addition, the Budget Control Act commits the U.S. Government to reduce the federal deficit by $1.2 trillion over ten years through a combination of automatic, across-the-board spending cuts and caps on discretionary spending. This “sequestration” under the Budget Control Act is split equally between defense and non-defense programs and went into effect on March 1, 2013. The Bipartisan Budget Act of 2013 provided some budget relief, reducing the discretionary sequester (and increasing funding) for FY2014 and FY2015 for both defense and non-defense programs.

The Electronics Group already has been significantly adversely affected by declines in the overall government defense market due to the effects of sequestration, and may be further affected if funding for programs in which we participate, either by selling services and products directly to U.S. government agencies or as a subcontractor to prime contractors such as Lockheed Martin, Northrop Grumman and Excelis, is reduced, delayed or cancelled. Our ability to obtain new contract awards also could be negatively affected.

Congress and the Administration continue to debate these funding issues, but reductions in U.S. military spending also could materially adversely affect the results of our Electronics Group, and we expect that certain military and defense programs will experience delays while the receipt of government approvals remain pending.

Future levels of governmental spending, including delays, declines or reallocations in the funding of certain programs could adversely affect our financial results, if we are unable to offset these changes with new business or cost reductions.

Suppliers

Interruptions in the supply of key components could disrupt production.

Some of our manufacturing services or products require one or more components that are available from a limited number of providers or from sole-source providers. In the past, some of the materials we use, including steel, certain forgings or castings, capacitors and memory and logic devices, have been subject to industry-wide shortages or capacity allocations. As a result, suppliers have been forced to allocate available quantities among their customers, and we have not been able to obtain all of the materials desired. Some of our suppliers have struggled to implement reliable quality control systems which can negatively impact our operating efficiency and financial results. In downward business cycles, the tightening of credit markets has threatened the financial viability of an increasing number of suppliers of key components and raw materials and forced unanticipated shutdowns. Our inability to reliably obtain these or any other materials when and as needed could slow production or assembly, delay shipments to our customers, impair the recovery of our fixed costs and increase the costs of recovering to customers' schedules, including overtime, expedited freight, equipment maintenance, operating inefficiencies, higher working capital and the obsolescence risks associated with larger buffer inventories. Each of these factors could adversely affect operating results.

Shortages or increased costs of utilities could harm our business and our customers.

We and our customers depend on a constant supply of electricity and natural gas from utility providers for the operation of our respective businesses and facilities. In the past, we have experienced power outages which reduced our ability to deliver products and meet our customers' demand for those products. If we or our customers experience future interruptions in service from these providers, our production and/or delivery of products could be negatively affected. Additionally, due to the heavy consumption of energy in our production process and the businesses of our customers, if the cost of energy significantly increases, our results of operations and those of our customers could be negatively impacted.

Execution

Contract terminations or delays could harm our business.

We often provide manufacturing services and products under contracts that contain detailed specifications, quality standards and other terms. If we are unable to perform in accordance with such terms, our customers might seek to terminate such contracts, demand price concessions or other financial consideration or downgrade our past performance rating, an increasingly critical factor in federal procurement competitions. Moreover, many of our contracts are subject to termination for convenience or upon default. These provisions could provide only limited recoveries of certain incurred costs or profits on completed work and could impose liability for our customers' costs in procuring undelivered items from another source. If any of our significant contracts were to be repudiated, terminated or not renewed, such as the Dana and Meritor contracts described above, we would lose substantial revenues, and our operating results as well as prospects for future business opportunities could be adversely affected. For example, as described above, our supply agreement with Dana represented approximately 58% of our revenues in 2013, and this agreement currently provides for its expiration on December 31, 2014, unless renewed by the parties.

We are subject to various audits, reviews and investigations, including private party "whistleblower" lawsuits, relating to our compliance with federal and state laws. Should our business be charged with wrongdoing, or determined not to be a "presently responsible contractor," we could be temporarily suspended or debarred for up to three or more years from receiving new government contracts or government-approved subcontracts.

We must operate more efficiently, or our results could suffer.

If we are unable to improve the cost, efficiency and yield of our operations, or if our costs increase, our financial results could suffer. A number of major obstacles could include: the loss of substantial revenues due to a sluggish economic recovery; inflationary pressures; increased borrowing due to declining sales; changes in anticipated product mix and the associated variances in our profit margins; efforts to increase our manufacturing capacity and launch new programs; efforts to migrate, restructure or move business operations from one location to another; the breakdown of critical machinery or equipment; the need to identify and eliminate our root causes of scrap; our ability to achieve expected annual savings or other synergies from past and future business combinations; inventory risks due to shifts in market demand; obsolescence; price erosion of raw material or component parts; shrinkage, or other factors affecting our inventory valuations; and an inability to successfully manage growth, contraction or competitive pressures in our primary markets.

Our management or systems could be inadequate to support our existing or future operations, especially as we downsize our operating staff to reduce expenses in any extended economic downturn. Growth in our business could require us to invest in additional equipment to improve our efficiency. We may have limited experience or expertise in installing or operating such equipment, which could negatively impact our ability to deliver products on time or with acceptable costs. In addition, a material portion of our manufacturing equipment requires significant maintenance to operate effectively, and we may experience maintenance and repair issues. Our efforts to restructure, relocate and consolidate a significant number of the operations, especially in our truck component manufacturing plants, could cause certain of these facilities to operate at underutilized levels, which could materially adversely affect our business, results of operations and financial condition. In our Electronics Group, the risk of technical failures, nonconformance with customer specifications, an inability to deliver next generation products or other quality concerns could materially impair our operating results.

Our growth strategies could be ineffective due to the risks associated with further acquisitions.

Our growth strategy has included acquiring complementary businesses. We could fail to identify, finance or complete suitable acquisitions on acceptable terms and prices. Acquisition efforts entail a number of risks, including: diversion of management's attention; difficulties in integrating systems, operations and cultures; potential loss of key employees and customers of the acquired companies; lack of experience operating in the geographic market of the acquired business; an increase in our expenses and working capital requirements; risks of entering into markets or producing products where we have limited or no experience; difficulties in integrating purchased technologies and products with our technologies and products; our ability to improve productivity and implement cost reductions; our ability to secure collective bargaining agreements with employees; and exposure to unanticipated liabilities.

Our discovery of, or failure to discover, material issues during due diligence investigations of acquisition targets, either before closing with regard to potential risks of the acquired operations, or after closing with regard to the timely discovery of breaches of representations or warranties, or of certain indemnified environmental conditions, could seriously harm our business.

Cyber security risks could negatively affect operations and result in increased costs.

Our Electronics Group, as a U.S. defense contractor, and our Company overall, face cyber security threats, threats to the physical security of our facilities and employees and terrorist acts, as well as the potential for business disruptions associated with information technology failures and natural disasters.

We routinely experience cyber security threats, threats to our information technology infrastructure and attempts to gain access to our sensitive information, as do our customers, suppliers and subcontractors. Prior cyber attacks directed at us have not had a material impact on our financial results. Due to the evolving nature of these security threats, however, the impact of any future incident cannot be predicted.

Although we work cooperatively with our customers and our suppliers, subcontractors, and other partners to seek to minimize the impacts of cyber threats, other security threats or business disruptions, we must rely on the safeguards put in place by those entities, and those safeguards might not be effective.

The costs related to cyber security or other security threats or disruptions may not be fully insured or indemnified by other means. Occurrence of any of these events could adversely affect our internal operations, the services we provide to customers, loss of competitive advantages derived from our research and development efforts, early obsolescence of our products and services, our future financial results, our reputation or our stock price.

Competition

Increasing competition could limit or reduce our market share.

We operate in highly competitive environments that include our customers' internal capabilities. We believe that the principal competitive factors in our markets include the availability of manufacturing capacity, technological strength, speed and flexibility in responding to design or schedule changes, price, quality, delivery, cost management and financial strength. Our earnings could decline if our competitors or customers can provide comparable speed and quality at a lower cost, or if we fail to adequately invest in the range and quality of manufacturing services and products our customers require.

Some of our competitors, as compared to us, are larger and have greater financial and organizational resources, geographic breadth and range of services, customer bases and brand recognition than we do. As a result, our competitors may respond more quickly to technological changes or customer needs, consume lower fixed and variable unit costs, negotiate reduced component prices, and obtain better terms for financing growth. If we fail to compete in any of these areas, we may lose market share and our business could be seriously harmed. There can be no assurance that we will not experience increased competition or that we will be able to maintain our profitability if our competitive environment changes.

Our technologies could become obsolete, reducing our revenues and profitability.

The markets for our products and services are characterized by changing technology and continuing process development. The future of our business will depend in large part upon the continuing relevance of our technological capabilities. We could fail to make required capital investments, develop or successfully market services and products that meet changing customer needs and anticipate or respond to technological changes in a cost-effective and timely manner. Our inability to successfully launch or sustain new or next generation programs or product features, especially in accordance with budgets or committed delivery schedules, could materially adversely affect our financial results. We could encounter competition from new or revised technologies that render our technologies and equipment less profitable or obsolete in our chosen markets and our operating results may suffer. In particular, the Company is currently developing new products and pursuing new programs in an attempt to replenish the Electronics Group’s revenue stream, which has been declining since 2009. However, commercializing the new products and programs is costly, has been slower than anticipated and is not expected to result in significant revenue in 2014. The launch of any new products or programs within the Electronics Group may not be successful.

Access to Capital

An inability to obtain favorable financing could impair our growth.

Our operating results could be materially adversely affected by *the costs and availability of debt or equity financing.* Our future liquidity and capital requirements are difficult to predict because they depend on numerous factors, including the pace at which we grow our business and acquire new facilities or the loss of anticipated revenues due to the effects of any extended economic downturn. One method we have used to obtain multi-year supply agreements is to buy a customer’s non-core manufacturing assets and produce products for them. We may need to raise substantial additional funds in order to pursue this strategy. We cannot be certain that we will be able to obtain additional financing on favorable terms or at all. Additional equity financing could result in dilution to existing holders. If additional financing is obtained in the form of debt, the terms of the debt could place restrictions on our ability to operate or increase the financial risk of our capital structure. Our ability to borrow under our credit facility (the “Credit Facility”) is conditioned upon our compliance with various financial covenants. We could lose our access to such financing if we experience adverse changes in our operations, poor financial results, increased risk profiles of our businesses, declines in our credit ratings, any actual or alleged breach of our debt covenants, insurance conditions or similar agreements or any adverse regulatory developments. In any extended economic downturn, we may need to raise capital through the sale of core or non-core assets or businesses, and our inability to successfully do so could materially adversely impact our operating results or access to sufficient capital.

Any inability to raise additional funds as needed could impair our ability to operate and grow our business. Such financing could be subject to a number of factors, including market conditions, our operating performance and investor sentiment. These factors may make the timing, amount, terms and conditions of additional financing unattractive for us.

We may be unable to comply with the covenants in our Credit Facility.

Our Credit Facility requires us to comply with certain financial covenants regarding cumulative quarterly fixed charge coverage ratios. The Credit Facility also 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. No assurances can be given that changing business, regulatory or economic conditions might not cause the Company to violate one or more covenants which could result in default or acceleration of any debt under the Credit Facility.

Labor Relations

We must attract and retain qualified employees while successfully managing related costs.

Our future success in a changing business environment, including during rapid changes in the size, complexity or skills required of our workforce, will depend to a large extent upon the efforts and abilities of our executive, managerial and technical employees. The loss of key employees, especially in a recovering economic environment, could have a material adverse effect on our operations. Our future success will also require an ability to attract and retain qualified employees, especially those with engineering or production expertise in our core business lines. Labor disputes or changes in the cost of providing pension and other employee benefits, including changes in health care costs, investment returns on plan assets and discount rates used to calculate pension and related liabilities or other requirements to accelerate the level of our pension fund contributions to reduce or eliminate underfunded liabilities, could lead to increased costs or disruptions of operations in any of our business units.

Disputes with labor unions could disrupt our business plans.

We currently have collective bargaining agreements covering approximately 500 employees (all of which are in the Industrial Group), or 42% of total employees. Excluding certain Mexico employees covered under an annually ratified agreement, collective bargaining agreements covering 149 employees expire within the next 12 months. Certain Mexico employees are covered by an annually ratified collective bargaining agreement. These employees represent approximately 26% of the Company’s workforce, or 311 employees. We could experience a work stoppage or other disputes which could disrupt our operations or the operations of our customers and could harm our operating results.

Regulatory

Environmental, health and safety risks could expose us to potential liability.

We are subject to a variety of environmental regulations relating to the use, storage, discharge and disposal of hazardous chemicals and substances used in our operations. If we fail to comply with present or future regulations, we could be forced to alter, suspend or discontinue our manufacturing processes and pay substantial fines or penalties.

Groundwater and other contamination has occurred at certain of our current and former facilities during the operation of those facilities by their former owners, and this contamination may occur at future facilities we operate or acquire. There is no assurance that environmental indemnification agreements we have secured from former owners of these properties will be adequate to protect us from liability.

The Marion, Ohio property formerly owned by Sypris is subject to soil and groundwater contamination involving petroleum compounds, semi-volatile and volatile organic compounds, certain metals, PCBs and other contaminants, some of which exceed the state voluntary action program standards applicable to the site. The property was sold in March 2013 to Whirlpool Corporation (Whirlpool). Whirlpool has indemnified the Company against the legacy environmental risks on the property.

We previously acquired certain business assets formerly located at a leased facility in Littleton, Colorado, where chlorinated solvents had been disposed of on site by a prior owner of the business at the site, contaminating the groundwater at and around the site. The seller of the assets to us is operating a remediation system on the site approved by the State of Colorado and has entered into a consent order with the EPA providing for additional investigation at the site. In addition, Sypris has been contractually indemnified by the prior owners of the facility.

Our Morganton, North Carolina facility is subject to soil and groundwater contamination involving petroleum compounds, certain metals and other contaminants, some of which may exceed the State of North Carolina standards applicable to the site. The Company is aware of no current litigation, material remediation claims or other proceedings with respect to this facility.

Our Toluca, Mexico facility is subject to soil and groundwater contamination involving petroleum compounds and volatile organic compounds, among other concerns. We continue to test and assess this site to determine the extent of any contamination by the prior owners of the facility. Under our purchase agreement for this facility, Dana has agreed to indemnify us for, among other things, environmental conditions that existed on the site as of closing and as to which we notified Dana prior to June 30, 2006, subject to certain other conditions involving Dana’s release of, or continuing right to seek indemnity from, Eaton, from which Dana acquired the property.

The Kenton, Ohio property formerly owned by Sypris is subject to soil and groundwater contamination involving petroleum compounds, volatile organic compounds, certain metals, PCBs and other contaminants. Under our purchase agreement for this property, Meritor agreed to indemnify us for, among other things, environmental conditions that existed on the site as of closing and as to which we notified Meritor prior to May 2, 2006. The building and real property were sold in January 2012.

Our business is also subject to potential liabilities with respect to health and safety matters. We are required to comply with federal, state, local and foreign laws and regulations governing the health and safety of our workforce, and we could be held liable for damages arising out of human exposure to hazardous substances or other dangerous working conditions. Health and safety laws and regulations are complex and change frequently. As a result, our future costs to comply with such laws or the liabilities incurred in the event of any violations may increase significantly.

Adverse regulatory developments or litigation could harm our business.

Our businesses operate in heavily regulated environments. We must successfully manage the risk of changes in or adverse actions under applicable law or in our regulatory authorizations, licenses and permits, governmental security clearances or other legal rights to operate our businesses, to manage our work force or to import and export goods and services as needed. Our business activities expose us to the risks of litigation with respect to our customers, suppliers, creditors, stockholders or from product liability, environmental or asbestos-related matters. We also face the risk of other adverse regulatory actions, compliance costs or governmental sanctions, as well as the costs and risks related to our ongoing efforts to design and implement effective internal controls.

Other Risks

We face other factors which could seriously disrupt our operations.

Many other risk factors beyond our control could seriously disrupt our operations, including: risks relating to war, future terrorist activities, computer hacking or other cyber attacks, or political uncertainties; risks relating to natural disasters or other casualties which could shut down our domestic or foreign facilities, disrupt transportation of products or supplies, increase the costs under our self insurance program or change the timing and availability of funding in our aerospace and defense electronics markets; risks inherent in operating abroad, including foreign currency exchange rates, adverse regulatory developments, and miscommunications or errors due to inaccurate foreign language translations or currency exchange rates; or our failure to anticipate or to adequately insure against other risks and uncertainties present in our businesses including unknown or unidentified risks.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our principal manufacturing services operations are engaged in electronics manufacturing services for our aerospace and defense customers and industrial manufacturing services for our truck components and assemblies customers. The following chart indicates the significant facilities that we own or lease, the location and size of each such facility and the manufacturing certifications that each facility possesses. The facilities listed below (other than the corporate office) are used principally as manufacturing facilities.

Location	Segment (Market Served)	Own or Lease (Expiration)	Approximate Square Feet	Certifications
Corporate Office:				
Louisville, Kentucky		Lease (2024)	21,600	
Manufacturing and Service Facilities:				
Louisville, Kentucky	Industrial Group (Truck Components & Assemblies; Specialty Closures)	Own	450,000	QS 9000 TS 16949
Morganton, North Carolina	Industrial Group (Truck Components & Assemblies)	Own	360,000	TS 16949 ISO 14001
Tampa, Florida	Electronics Group (Aerospace & Defense Electronics)	Lease (2016)	318,000	ISO 9001 ISO 14001 AS 9100 NASA-STD-8739 IPC-A-610, Rev D, Class 3 J-STD-001, Rev D, Class 3 CMMI Level 3
Toluca, Mexico	Industrial Group	Own	217,000	TS 16949

(Truck Components

& Assemblies)

In addition, we lease space in one other facility in Copenhagen, Denmark, which is utilized as a sales office for our Electronics Group.

Below is a listing and description of the various manufacturing certifications or specifications that we utilize at our facilities.

Certification/Specification	**Description**
AS 9100	A quality management system developed by the aerospace industry to measure supplier conformance with basic common acceptable aerospace quality requirements.
IPC-A-610	A certification process for electronics assembly manufacturing which describes materials, methods and verification criteria for producing high quality electronic products. Class 3 specifically includes high performance or performance-on-demand products where equipment downtime cannot be tolerated, end-use environment may be uncommonly harsh, and the equipment must function when required.

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J-STD-001	A family of voluntary standards of industry-accepted workmanship criteria for electronic assemblies.
CMMI Level-3	An internationally recognized measure of an organization's engineering process maturity.
ISO 9001	A certification process comprised of quality system requirements to ensure quality in the areas of design, development, production, installation and servicing of products.
ISO 14001	A family of voluntary standards and guidance documents defining specific requirements for an Environmental Management System.
NASA-STD-8739	A specification for space programs designated by the National Aeronautics and Space Administration.
QS 9000	A certification process developed by the nation's major automakers that focuses on continuous improvement, defect reduction, variation reduction and elimination of waste.
TS 16949	A quality certification system developed within the automotive sector. Using ISO 9001:2000 as its foundation, ISO/TS 16949:2002 specifies the quality management system (QMS) requirements for the design, development, production, installation and servicing of automotive related products.

Item 3. Legal Proceedings

We are involved from time to time in litigation and other legal or environmental proceedings incidental to our business. There are currently no material pending legal proceedings to which we are a party. Ongoing environmental matters include the following:

The Marion, Ohio property formerly owned by Sypris is subject to soil and groundwater contamination involving petroleum compounds, semi-volatile and volatile organic compounds, certain metals, PCBs and other contaminants, some of which exceed the State of Ohio voluntary action program standards applicable to the site. The property was sold in March 2013 to Whirlpool. Whirlpool has indemnified the Company against the legacy environmental risks on the property.

In December 1992, we acquired certain business assets formerly located at a leased facility in Littleton, Colorado. Certain chlorinated solvents disposed of on the site by Honeywell, a previous owner of the business, have contaminated the groundwater at and around the site. Alliant Techsystems, from which we acquired the business assets, operates a remediation system approved by the State of Colorado and has also entered into a consent order with the EPA providing for additional investigation at the site. Alliant Techsystems has agreed to indemnify us with respect to these matters.

Our Morganton, North Carolina facility is subject to soil and groundwater contamination involving petroleum compounds, certain metals and other contaminants, some of which exceed the State of North Carolina notification standards applicable to the site. No litigation or other proceedings are underway with respect to this site.

Our Toluca, Mexico facility is subject to soil and groundwater contamination involving petroleum compounds and volatile organic compounds, among other concerns. Under our purchase agreement for this facility, Dana has agreed to indemnify us for, among other things, environmental conditions that existed on the site as of closing and as to which we notified Dana prior to June 30, 2006, to the extent of any indemnification owed to Dana by Eaton or any other matters for which Dana has released Eaton.

The Kenton, Ohio property formerly owned by Sypris is subject to soil and groundwater contamination involving petroleum compounds, volatile organic compounds, certain metals, PCBs and other contaminants. Under our purchase agreement for this facility, Meritor has agreed to indemnify us for, among other things, environmental conditions that existed on the site as of closing and as to which we notified Meritor prior to May 2, 2006. The building and real property were sold in January 2012, and the building was subsequently razed by the buyer. Under the terms of the sale agreement, no warranties relating to the property were made including existing environmental conditions and all liability has been passed to the buyer.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

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 performance graph required in paragraph (e) of Item 201 of Regulation S-K.

Our common stock is traded on the NASDAQ Global Market under the symbol “SYPR.” The following table sets forth, for the periods indicated, the high and low closing sale prices per share of our common stock as reported by the NASDAQ Global Market.

	High	**Low**
Year ended December 31, 2013:		
First Quarter	$4.49	$3.60
Second Quarter	3.96	3.06
Third Quarter	3.39	3.03
Fourth Quarter	3.22	2.57
Year ended December 31, 2012:		
First Quarter	$4.25	$3.77
Second Quarter	6.97	3.95
Third Quarter	7.56	5.65
Fourth Quarter	7.28	3.58

As of March 4, 2014, there were 735 holders of record of our common stock. The amount of cash dividends declared per share for each fiscal quarter in 2013 and 2012 is presented in the table below.

	Dividends per Common Share

Year ended December 31, 2013:	$ 0.02
First Quarter	0.02
Second Quarter	0.02
Third Quarter	0.02
Fourth Quarter	
Year ended December 31, 2012:	
First Quarter	$ 0.02
Second Quarter	0.02
Third Quarter	0.02
Fourth Quarter	0.02

Dividends may be paid on common stock only when, as and if declared by our Board of Directors in its sole discretion. The Company's Credit Facility contains restrictions related to dividend payments, as further described in "Management's Discussion and Analysis of Financial Condition and Results of Operations–Liquidity" below.

The following table summarizes our shares of common stock repurchased during the three months ended December 31, 2013 (dollars in thousands except per share data):

Period	**Total Number** of Shares Purchased (a)	**Average Price** Paid per Share	**Total Number of Shares Purchased** as a Part of Publicly Announced Plans or Programs	**Maximum Dollar Value of Shares** that May Yet Be Purchased Under the Plans or Programs (b)
9/30/2013 – 10/27/2013	—	$ —	—	$ 4,330
10/28/2013 – 11/24/2013	10,763	$ 3.16	8,675	$ 4,303
11/25/2013 – 12/31/2013	—	$ —	—	$ 4,303

(a) The total number of shares purchased includes shares purchased under the Executive Equity Repurchase Agreement (described below). The Company also withholds shares from employees to satisfy either the exercise price of stock options exercised or the statutory withholding tax liability resulting from the vesting of restricted stock awards. Shares of common stock withheld to satisfy tax withholding obligations were immediately cancelled.

(b) On December 20, 2011, our Board of Directors approved and we announced an authorization for the repurchase of up to $5.0 million of our outstanding shares of common stock. The Board also authorized an Executive Equity Repurchase Agreement whereby management, including officers and directors, would grant the Company a first right to purchase shares held by such individuals, at current market prices (calculated as the average of the previous five days' closing prices), any time a party to the agreement departed the Company or intended to sell more than 1,500 shares of common stock. The agreement has a five-year term, subject to earlier termination by the Company, and participation by each individual is voluntary.

Item 6. Selected Financial Data

We are a smaller reporting company as defined in Item 10(f)(1) of Regulation S-K and thus are not required to report the selected financial data in Item 301 of Regulation S-K.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of our consolidated results of operations and financial condition should be read together with the other financial information and consolidated financial statements included in this Annual Report on Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from the results anticipated in the forward-looking statements as a result of a variety of factors, including those discussed in "Item 1A. Risk Factors" and elsewhere in this Annual Report on Form 10-K.

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 sole-source contracts with corporations and government agencies principally in the markets for industrial manufacturing and aerospace and defense electronics.

We are organized into two business groups, the Industrial Group and the Electronics Group. The Industrial Group, which is comprised of Sypris Technologies, Inc. and its subsidiaries, generates revenue primarily from the sale of manufacturing services to customers in the market for truck components and assemblies and from the sale of products to the energy and chemical markets. The Electronics Group, which is comprised of Sypris Electronics, LLC and its subsidiary, generates revenue primarily from the sale of manufacturing services, technical services and products to customers in the market for 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, historically, have been renewed for terms of five years or more, enable us to invest in leading-edge processes or technologies to help our customers remain competitive. The productivity, flexibility and economies of scale that can result offer an important opportunity for differentiating ourselves from our competitors when it comes to cost, quality, reliability and customer service.

Electronics Group Outlook

We continue to face challenges within the Electronics Group, such as the conclusion of several U.S. Department of Defense programs that the Company supported as a subcontractor, the loss of a key commercial space customer who decided to begin insourcing programs that had been previously outsourced to the Electronics Group, the uncertainty in the worldwide macroeconomic climate and its impact on aerospace and defense spending patterns globally, the emergence of new competitors to our product and service offerings, as well as federal government spending uncertainties in the U.S.

The Electronics Group’s revenue has declined year-over-year since 2009 primarily due to our inability to replace the declining demand for certain legacy products and services with competitive new offerings. While we do not yet have a pipeline of programs or other contract awards to replace these legacy programs in the near term, the Company is currently developing new products and pursuing new programs to attempt to replenish its revenue stream within the Electronics Group. The U.S. Government's continued focus on addressing federal budget deficits and the growing national debt exacerbates this challenging environment for the Electronics Group. In addition, the Budget Control Act commits the U.S. Government to reduce the federal deficit by $1.2 trillion over ten years through a combination of automatic, across-the-board spending cuts and caps on discretionary spending. The deficit-reduction “sequestration” under the Budget Control Act is split equally between defense and non-defense programs and went into effect on March 1, 2013. However, the Bipartisan Budget Act of 2013 provided some budget relief, reducing the discretionary sequester (and increasing funding) for fiscal year 2014 and fiscal year 2015 for both defense and non-defense programs. Unless Congress passes a similar law providing budget relief beyond fiscal year 2015, the full sequester cuts will go back into effect for fiscal year 2016. In addition, in February 2014, the Pentagon announced that its budget request for fiscal year 2015 would exceed the sequester caps but would be below the funding in the President’s fiscal year 2014 budget request. Congress and the Administration continue to debate these long- and short-term funding issues, but reductions in U.S. military spending could materially adversely affect the results of our Electronics Group, and we expect that certain military and defense programs will experience delays while the receipt of government approvals remain pending.

As a result, the Company expects ongoing uncertainty and the potential for further revenue declines within this segment for at least the next twelve months. For the longer term, we are continuing to make investments and evaluate new investments in products and programs to further improve the attractiveness of our business portfolio, with a specific emphasis on trusted solutions for identity management, cryptographic key distribution and cyber analytics. There can be no assurance that the Company's investment in and efforts to introduce new products and services will result in new business or revenue. In addition, while the Company continues to evaluate and implement cost reduction measures in this segment, the Company may not be able to reduce its cost structure to offset the impact of lower revenues. Should revenues decrease further in the coming periods, the Company might be required to implement further cost reductions or other downsizing measures, which could be costly and adversely impact our financial performance.

Industrial Group Outlook

General economic and industry specific conditions have begun to stabilize for our Industrial Group, and improvements in the overall U.S. economy contributed to improved consumer confidence levels in 2013. In North America, production levels for light, medium and heavy duty trucks have steadily increased over the past four years from a low in the depressed economic environment of 2008 and 2009. Subject to the renewal status of our supply contracts with Dana and Meritor, we continue to expect modest growth in production levels within our Industrial Group through 2014 and 2015, though our Industrial Group's revenue declined slightly in 2013, as compared with 2012, due to cyclical slowdowns in the industry and minor changes in our customers' market shares of some products.

Sypris and Dana have recently signed an amended and restated supply agreement, the binding effect of which is currently in dispute. Dana has repudiated this agreement and purported to exercise its rights under the prior agreement to begin exploring alternative supply relationships with third parties, including the right to sign new supply agreements, authorize tooling expenditures and engage in certain production part approval processes (PPAP) with respect to the goods currently supplied by Sypris. Sypris disputes Dana's ability to exercise such rights. In addition, Dana has notified us that it intends to terminate its supply relationship with us effective December 31, 2014 and to transition over 2,000 active part numbers, which we currently manufacture for Dana, to alternative suppliers at the expiration date of the original supply agreement. The failure to resolve this dispute with Dana on acceptable terms would have a material adverse effect on our financial condition and financial performance.

In addition, two of the Company's current agreements with Meritor are due to expire at the end of 2014 and mid-2015, respectively. The failure to enter into an agreement with Meritor on acceptable terms, or the entry into agreements for fewer products or reduced volumes or prices would have a material adverse effect on our financial condition and financial performance.

In 2013, Dana and Meritor represented approximately 58% and 15% of our net revenue, respectively.

Critical Accounting Policies and Estimates

The preparation of the consolidated financial statements and accompanying notes in conformity with U.S. generally accepted accounting principles requires that we make estimates and assumptions that affect the amounts reported. Changes in facts and circumstances could have a significant impact on the resulting estimated amounts included in our consolidated financial statements. We believe the following critical accounting policies affect our more complex judgments and estimates. We also have other policies that we consider to be key accounting policies, such as our policies for revenue recognition in the Industrial Group, including cost of sales; however, these policies do not meet the definition of critical accounting policies because they do not generally require us to make estimates or judgments that are difficult or subjective.

Allowance for Doubtful Accounts. We establish reserves for uncollectible accounts receivable based on overall receivable aging levels, a specific evaluation of accounts for customers with known financial difficulties and evaluation of customer chargebacks, if any. These reserves and corresponding write-offs could significantly increase if our customers experience deteriorating financial results or in the event we receive a significant chargeback, which is deemed uncollectible.

Goodwill. Goodwill is tested for impairment annually as of December 31 or more frequently if impairment indicators arise. If impairment indicators arise, a step one assessment is performed to identify any possible goodwill impairment in the period in which the indicator is identified. The December 31, 2012 review of goodwill indicated that goodwill was not impaired. Beginning in March 2013, we noted certain indicators relating to our Electronics Group reporting unit that were significant enough to conclude that an impairment indicator existed as of March 31, 2013. Specifically, one key customer within the Electronics Group’s space business communicated its strategic sourcing decision to begin insourcing programs that had been previously outsourced to the Electronics Group. Overall, the Electronics Group has been more impacted by declines in the overall government defense market than originally anticipated as the effects of sequestration have become clearer since its initial effective date on March 1, 2013. For example, sales of certain data recording products were significantly reduced due to the impact of sequestration on our customers, and the loss of commercial space business was due in part to our customer’s efforts to offset unrelated losses of government business due to sequestration. As a result, the Electronics Group’s short term revenue forecasts were materially affected.

For purposes of the 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 for 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 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 in considering whether goodwill may be impaired. 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 identified assets and liabilities of the reporting unit. As part of this process, the Company reviewed the recoverability of the Electronics Group’s short-term and long-term assets excluding goodwill and concluded that no impairment of these assets was necessary.

The cash flow analysis, discount rate and terminal value all require significant judgment and significantly influence our evaluation of each reporting unit and its estimated fair value. 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 uncertainty.

Key assumptions used to determine the fair value of the Electronics Group included the expected after-tax cash flows for the period from 2013 to 2017 and a terminal growth rate of 3.0%, which is consistent with historical expectations. Our analysis also included a comparison of our market capitalization to the estimated fair value for the entire enterprise. Significant assumptions utilized during the valuation process are impacted by economic conditions and expectations of management and may change in the future based on period-specific facts and circumstances.

The first step of the impairment test indicated that the estimated fair value for the Electronics Group was less than its carrying value as of March 31, 2013. We performed step two of the impairment test and determined that the implied goodwill for the reporting unit was lower than its value as of March 31, 2013. As a result, a non-cash impairment charge of $6.9 million was recorded during the three months ended March 31, 2013 to impair the goodwill associated with the Electronics Group reporting unit. The impairment charge has been presented separately in the consolidated statements of operations and fully impairs the carrying amount of goodwill related to the Electronics Group. The fair value of the Electronics Group and the assets and liabilities identified in the step two impairment test were determined using the combination of the income approach and the market approach, which are Level 3 and Level 2 inputs, respectively.

Net Revenue and Cost of Sales. Net revenue of products and services under commercial terms and conditions are recorded upon delivery and passage of title, or when services are rendered. Related shipping and handling costs, if any, are included in costs of sales.

Net revenue on fixed-price contracts is recognized as services are performed. Revenue is deferred until all of the following have occurred (1) there is a contract in place, (2) delivery has occurred, (3) the price is fixed or determinable, and (4) collectability is reasonably assured. Contract profits are taken into earnings based on actual cost of sales for units shipped. Amounts representing contract change orders or claims are included in revenue when such costs are invoiced to the customer.

Periodically the Company enters into research and development contracts with customers related primarily to key encryption products. When the contracts provide for milestone or other interim payments, the Company will recognize revenue under the milestone method. The Company had one contract in process during fiscal year 2013 being accounted for under the milestone method. The milestone method requires the Company to deem all milestone payments within each contract as either substantive or non-substantive. That conclusion is determined based upon a thorough review of each contract and the Company's deliverables committed to in each contract. For substantive milestones, the Company concludes that upon achievement of each milestone, the amount of the corresponding defined payment is commensurate with the effort required to achieve such milestone or the value of the delivered item. The payment associated with each milestone relates solely to past performance and is deemed reasonable upon consideration of the deliverables and the payment terms within the contract. For non-substantive milestones, including advance payments, the recognition of such payments are pro-rated to the substantive milestones. Milestones may include, for example, the successful completion of design review or technical review, the submission and acceptance of technical drawings, delivery of hardware, software, spares, test equipment or regulatory agency certifications. During fiscal year 2013, revenue recognized through the achievement of multiple milestones amounted to $0.7 million.

Long-lived asset impairment. We perform periodic impairment analysis on our long-lived amortizable assets whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. When indicators are present, we compare the estimated future undiscounted net cash flows of the operations to which the assets relate to their carrying amount. If the operations are unable to recover the carrying amount of their assets, the long-lived assets are written down to their estimated fair value. Fair value is determined based on discounted cash flows, third party appraisals or other methods that provide appropriate estimates of value. A considerable amount of management judgment and assumptions are required in performing the impairment test, principally in determining whether an adverse event or circumstance has triggered the need for an impairment review.

The Industrial Group performed an asset recoverability test for one of its asset groups totaling approximately $40.6 million as of December 31, 2013. The Company concluded that the undiscounted sum of estimated future cash flows exceeded the carrying value for such asset group, and accordingly, no impairment was recognized. While we believe our judgments and assumptions were reasonable, changes in assumptions underlying these estimates could result in a material impact to our consolidated financial statements in any given period.

Pension Plan Funded Status. The calculation of pension assets and liabilities involve complex estimation processes dependent on assumptions developed by us in consultation with our outside advisors such as actuaries. The assumptions used, including discount rates and return on plan assets, have a significant impact on plan expenses and obligations. Changes in these rates could significantly impact the actuarially determined amounts recorded in the consolidated balance sheets. If actual experience differs from expectations, our financial position and results of operations in future periods could be affected.

A change in the assumed pension discount rate of 100 basis points would result in a change in our pension obligation as of December 31, 2013 of $3.8 million. A change in the assumed rate of return on plan assets of 100 basis points would result in a $0.4 million change in the estimated 2014 pension expense.

Discount rates are based upon the construction of a theoretical bond portfolio, adjusted according to the timing of expected cash flows for the future obligations. A yield curve is based on a subset of these fixed income investments. The projected cash flows are matched to this yield curve and a present value is developed which is then calibrated to develop a single equivalent discount rate. Pension benefits are funded through deposits with trustees that satisfy, at a minimum, the applicable funding regulations. Expected investment rates of return are based upon input from the plan's investment advisors and actuary regarding our expected investment portfolio mix, historical rates of return on those assets, projected future asset class returns and long-term market conditions and inflation expectations. We believe that the long-term asset allocation on average will approximate the targeted allocation, and we regularly review the actual asset allocation to periodically rebalance the investments to the targeted allocation when appropriate.

Actuarial gains or losses may result from changes in assumptions or when actual experience is different from that expected. Under applicable standards, those gains and losses are not required to be immediately recognized as expense, but instead may be deferred as part of accumulated other comprehensive income and amortized into expense over future periods.

Reserve for Excess, Obsolete and Scrap Inventory. We record inventory at the lower of cost, determined under the first-in, first-out method, or market, and we reserve for excess, obsolete or scrap inventory. These reserves are primarily based upon management's assessment of the salability of the inventory, historical usage of raw materials, historical demand for finished goods and estimated future usage and demand. An improper assessment of salability or improper estimate of future usage or demand, or significant changes in usage or demand could result in significant changes in the reserves and a positive or a negative impact on our consolidated results of operations in the period the change occurs.

Stock-based Compensation. We account for stock-based compensation in accordance with the fair value recognition provisions using the Black-Scholes option-pricing method, which requires the input of several subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them (expected term), the estimated volatility of our common stock price over the expected term and the number of options that will ultimately not complete their vesting requirements (forfeitures). Changes in the subjective assumptions can materially affect the fair value estimate of stock-based compensation and consequently, the related expense recognized in the consolidated statements of operations.

Income Taxes. We account for income taxes as required by the provisions of ASC 740, *Income Taxes*, under which deferred tax assets and liabilities are recognized for the tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities measured using enacted tax rates.

Management judgment is required in determining income tax expense and the related balance sheet amounts. In addition, under ASC 740-10, *Accounting for Uncertainty in Income Taxes,* judgments are required concerning the ultimate outcome of uncertain income tax positions. Actual income taxes paid may vary from estimates, depending upon changes in income tax laws, actual results of operations and the final audit of tax returns by taxing authorities. Tax assessments may arise several years after tax returns have been filed. We believe that our recorded income tax liabilities adequately provide for the probable outcome of these assessments.

Deferred tax assets are also recorded for operating losses and tax credit carryforwards. However, ASC 740 requires that a valuation allowance be recorded when it is more likely than not that some portion or all of the deferred tax assets will not be realized. This assessment is largely dependent upon projected near-term profitability including the effects of tax planning. Deferred tax assets and liabilities are determined separately for each tax jurisdiction in which we conduct our operations or otherwise incur taxable income or losses. We have recorded valuation allowances against deferred tax assets in the U.S. and Mexico where realization has been determined to be uncertain. However, our Mexican operation, which has historically generated taxable income and expects to continue to be profitable for the foreseeable future, also has certain deferred tax assets that are expected to be realized and therefore no valuation allowance has been recorded against such assets as of December 31, 2013. Since future financial results may differ from previous estimates, periodic adjustments to our valuation allowance may be necessary.

Results of Operations

We operate in two segments, the Industrial Group and the Electronics Group. The table presented below compares our segment and consolidated results of operations from 2013 to 2012. The table presents the results for each year, the change in those results from one year to another in both dollars and percentage change and the results for each year 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 each segment's net revenue. These amounts are shown in italics.

In addition, as used in the table, "NM" means "not meaningful."

Year Ended December 31, 2013 Compared to Year Ended December 31, 2012

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Over Year Change Favorable (Unfavorable)	Year Over Year Percentage Change Favorable (Unfavorable)	Results as Percentage of Net Revenue for the Year Ended December 31, 2013	Results as Percentage of Net Revenue for the Year Ended December 31, 2012
	(in thousands, except percentage data)					
Net revenue:						
Industrial Group	$276,136	$286,046	$ (9,910)	(3.5)%	88.9 %	83.7 %
Electronics Group	34,578	55,558	(20,980)	(37.8)	11.1	16.3
Total net revenue	310,714	341,604	(30,890)	(9.0)	100.0	100.0

Cost of sales:						
Industrial Group	244,498	255,065	10,567	4.1	*88.5*	*89.2*
Electronics Group	36,163	42,790	6,627	15.5	*104.6*	*77.0*
Total cost of sales	280,661	297,855	17,194	5.8	90.3	87.2
Gross profit (loss):						
Industrial Group	31,638	30,981	657	2.1	*11.5*	*10.8*
Electronics Group	(1,585)	12,768	(14,353)	(112.4)	*(4.6)*	*23.0*
Total gross profit	30,053	43,749	(13,696)	(31.3)	9.7	12.8
Selling, general and administrative	30,464	30,797	333	1.1	9.8	9.0
Research and development	3,047	3,816	769	20.2	1.0	1.1
Amortization of intangible assets	30	89	59	66.3	0.0	0.0
Impairment of goodwill	6,900	—	(6,900)	NM	2.2	—
Operating (loss) income	(10,388)	9,047	(19,435)	NM	(3.3)	2.7
Interest expense, net	522	437	(85)	(19.5)	0.2	0.1
(Gain) on sale of marketable securities	—	(1,850)	(1,850)	NM	—	(0.5)
Other (income), net	(930)	(2,055)	(1,125)	(54.7)	(0.3)	(0.6)
(Loss) income from continuing operations before income taxes	(9,980)	12,515	(22,495)	NM	(3.2)	3.7
Income tax (benefit) expense	(93)	2,248	2,341	NM	—	0.7
(Loss) income from continuing operations	(9,887)	10,267	(20,154)	NM	(3.2)	3.0
Loss from discontinued operations, net of tax	—	(7,220)	7,220	NM	—	(2.1)
Net (loss) income	$(9,887)	$3,047	$ (12,934)	NM	(3.2)%	0.9 %

Net Revenue. The Industrial Group derives its revenue from manufacturing services and product sales. Net revenue in the Industrial Group decreased $9.9 million from the prior year to $276.1 million in 2013. Decreased volumes for medium and heavy-duty truck components contributed to decreased revenue of approximately $8.7 million. Additionally, lower volumes for trailer axle beams and for the off-highway business contributed to lower revenues of $3.9 million and $1.0 million, respectively. Partially offsetting these decreases was an increase in sales of our specialty closure products of $2.2 million and an increase in light vehicle volumes of $0.3 million. Additionally, increased steel prices, which are contractually passed through to customers under certain contracts, contributed to increased revenue of approximately $1.1 million in 2013.

The Electronics Group derives its revenue from product sales and technical outsourced services. Net revenue in the Electronics Group decreased $21.0 million to $34.6 million in 2013, primarily due to the completion of certain electronic manufacturing and engineering services programs. The Electronics Group is currently developing new products and pursuing new programs in an attempt to replenish its revenue stream; however, commercializing the new products and programs is costly, has been slower than anticipated and is not expected to result in significant revenue in 2014. Additionally, the Electronics Group's outlook continues to be negatively affected by budgetary and funding uncertainty within the U.S. Department of Defense. For information about the budgetary and funding uncertainty, see "Risk Factors – Congressional budgetary constraints or reallocations could reduce our government sales" in Part I, Item 1A. of this Annual Report on Form 10-K.

Gross Profit. The Industrial Group's gross profit increased $0.7 million to $31.6 million in 2013 as compared to $30.9 million in the prior year. The Industrial Group realized an increase in gross profit of $4.1 million as a result of productivity improvements and lower project expenses in 2013. Price increases resulted in an increase in gross profit of $0.4 million over the prior year. Offsetting these increases was a net decrease in sales volumes across the previously discussed product and service offerings, which resulted in a decrease in gross profit of approximately $1.4 million, and higher utilities, inflationary items and unfavorable foreign exchange rates, which resulted in a $2.3 million decrease in gross profit.

The Electronics Group's gross profit decreased $14.4 million to a loss of $1.6 million in 2013. The decrease is primarily the result of lower revenues and an unfavorable mix in sales of lower margin products and services.

Selling, General and Administrative. Selling, general and administrative expense decreased $0.3 million to $30.5 million in 2013 as compared to $30.8 million in 2012. Selling, general and administrative expense increased as a percentage of revenue to 9.8% in 2013 from 9.0% in 2012. The decrease in selling, general and administrative expense for 2013 was due to a $1.1 million write-off of pre-contract costs in 2012 when it was determined that certain pre-contract costs could no longer be capitalized due to then current market events involving a specific contract offset by an increase in 2013 in salaries, fringes and legal expenses within our Industrial Group.

Research and Development. Research and development costs were $3.0 million and $3.8 million for the years ended December 31, 2013 and 2012, respectively, primarily in support of the Electronics Group's self-funded product and technology development activities.

Impairment of Goodwill. Goodwill is tested for impairment annually as of December 31 or more frequently if impairment indicators arise. If impairment indicators arise, a step one assessment is performed to identify any possible goodwill impairment in the period in which the indicator is identified. The December 31, 2012 review of goodwill indicated that goodwill was not impaired. Beginning in March 2013, we noted certain indicators relating to our Electronics Group reporting unit that were significant enough to conclude that an impairment indicator existed. Specifically, one key customer within the Electronics Group's space business communicated its strategic sourcing decision to begin insourcing programs that had been previously outsourced to the Electronics Group. Overall, the Electronics Group has been more impacted by declines in the overall government defense market than originally anticipated as the effects of sequestration have become clearer since its initial effective date on March 1, 2013. For example, sales of certain data recording products were significantly reduced due to the impact of sequestration on our customers, and the loss of commercial space business was due in part to our customer's efforts to offset unrelated losses of government business due to sequestration. Consequently, the Electronics Group's short term revenue forecasts were materially affected. As a result of the analysis, the Electronics Group's goodwill was deemed to be impaired, resulting in a non-cash impairment charge of $6.9 million for the year ended December 31, 2013, representing the segment's entire goodwill balance.

Interest Expense, Net. Interest expense for the year ended December 31, 2013 increased $0.1 million primarily due to an increase in the weighted average debt outstanding. The weighted average interest rate remained flat at 2.4% in 2013, while our weighted average debt outstanding increased to $13.2 million during 2013 from $10.9 million during 2012.

Other (Income), Net. Other (income), net decreased $1.1 million to $0.9 million for 2013 from $2.1 million in 2012. Other income, net for the year ended December 31, 2013 includes gains of $1.5 million from the sale of idle assets primarily within the Industrial Group offset by foreign currency transaction losses of $0.3 million related to the net U.S. dollar denominated monetary asset position of our Mexican subsidiaries for which the Mexican peso is the functional currency. Other income for the year ended December 31, 2012 includes a gain of $2.6 million from the sale of idle assets within the Industrial Group, partially offset by foreign currency related losses of $0.8 million.

Income Taxes. The 2013 income tax provision consists of current tax expense of $1.2 million and a deferred tax benefit of $1.3 million. The 2012 income tax provision consists of current and deferred tax expense of $1.4 million and $0.9 million, respectively. The current tax expense in both years is primarily attributable to taxes paid by our Mexican subsidiaries. The 2013 deferred tax benefit includes a $2.4 million benefit recorded due to the required intraperiod tax allocation resulting from the loss from continuing operations and other comprehensive income. Additionally, included in deferred taxes in both years is an increase in the valuation allowance on U.S. deferred tax assets. Our Mexican subsidiaries recognized a deferred tax benefit in both years related to the recovery of certain deferred tax assets that were previously reserved for by a valuation allowance.

Discontinued Operations. On October 26, 2009, the Company sold all of the stock of its wholly owned subsidiary, Sypris Test & Measurement, Inc. ("Sypris Test & Measurement") for $39.0 million, of which $3.0 million was deposited in an escrow account in connection with certain customary representations, warranties, covenants and indemnifications of the Company and was classified as restricted cash on the Company's consolidated balance sheets as of December 31, 2011. During 2010, the Company was made aware of a potential indemnification claim from the purchaser of Sypris Test & Measurement, and the parties engaged in binding arbitration to resolve the claim. During 2012, the arbitration dispute was settled for $6.5 million, which includes the counterparty's legal fees and expenses. Both parties have entered a mutual release of all related potential claims. This amount was paid in October 2012. The Company also incurred legal expenses of $0.7 million during 2012, in connection with the claim. These charges are included in loss from discontinued operations, net of tax in the consolidated statements of operations.

Quarterly Results

The following table presents our unaudited condensed consolidated statements of operations data for each of the eight quarters in the two-year period ended December 31, 2013. The quarterly results are presented on a 13-week period basis. We have prepared this data on the same basis as our audited consolidated financial statements and, in our opinion, have included all normal recurring adjustments necessary for a fair presentation of this information. You should read these unaudited quarterly results in conjunction with our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. The consolidated results of operations for any quarter are not necessarily indicative of the results to be expected for any subsequent period.

	2013				**2012**			
	First	**Second**	**Third**	**Fourth**	**First**	**Second**	**Third**	**Fourth**
	(in thousands, except per share data)							
Net revenue:								
Industrial Group	$71,149	$74,432	$66,650	$63,905	$82,522	$82,850	$65,176	$55,498
Electronics Group	7,262	7,734	9,628	9,954	13,941	16,062	13,587	11,968
Total net revenue	78,411	82,166	76,278	73,859	96,463	98,912	78,763	67,466
Cost of sales:								
Industrial Group	63,039	65,574	59,233	56,652	72,600	73,944	58,602	49,919
Electronics Group	7,296	8,256	9,784	10,827	11,349	11,745	10,787	8,909
Total cost of sales	70,335	73,830	69,017	67,479	83,949	85,689	69,389	58,828
Gross profit (loss):								
Industrial Group	8,110	8,858	7,417	7,253	9,922	8,906	6,574	5,579
Electronics Group	(34)	(522)	(156)	(873)	2,592	4,317	2,800	3,059
Total gross profit	8,076	8,336	7,261	6,380	12,514	13,223	9,374	8,638
Selling, general and administrative	7,158	7,598	7,689	8,019	7,595	7,698	7,633	7,871
Research and development	877	1,419	547	204	394	1,035	1,084	1,303
Amortization of intangible assets	22	8	—	—	22	22	22	23
Impairment of goodwill	6,900	—	—	—	—	—	—	—
Operating (loss) income	(6,881)	(689)	(975)	(1,843)	4,503	4,468	635	(559)
Interest expense, net	146	120	124	132	117	105	98	117
(Gain) on sale of marketable securities	—	—	—	—	—	(537)	(1,313)	—
Other (income) expense, net	(1,195)	(259)	38	486	(2,074)	(457)	561	(85)
(Loss) income from continuing operations, before tax	(5,832)	(550)	(1,137)	(2,461)	6,460	5,357	1289	(591)
Income tax expense (benefit)	627	944	858	(2,522)	949	343	697	259
(Loss) income from continuing operations	(6,459)	(1,494)	(1,995)	61	5,511	5,014	592	(850)
Loss from discontinued operations, net of tax	—	—	—	—	(223)	(576)	(6,331)	(90)
Net (loss) income	$(6,459)	$(1,494)	$(1,995)	$61	$5,288	$4,438	$(5,739)	$(940)
Basic (loss) income per share:								

(Loss) income per share from continuing operations	$(0.34)	$(0.08)	$(0.10)	$—	$0.28	$0.25	$0.03	$(0.04)
Loss per share from discontinued operations	—	—	—	—	(0.01)	(0.03)	(0.33)	(0.01)
Net (loss) income per share	$(0.34)	$(0.08)	$(0.10)	$—	$0.27	$0.22	$(0.30)	$(0.05)
Diluted (loss) income per share:								
(Loss) income per share from continuing operations	$(0.34)	$(0.08)	$(0.10)	$—	$0.28	$0.25	$0.03	$(0.04)
Loss per share from discontinued operations	—	—	—	—	(0.01)	(0.03)	(0.32)	(0.01)
Net (loss) income per share	$(0.34)	$(0.08)	$(0.10)	$—	$0.27	$0.22	$(0.29)	$(0.05)

Liquidity and Capital Resources

The Company's Credit Facility provides potential total availability of up to $50.0 million with an option, subject to certain conditions, to increase total potential availability to $60.0 million in the future. Loans made under the Credit Facility will mature and the commitments thereunder will terminate in May 2016. Actual 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. Based on that calculation, at December 31, 2013, we had actual total borrowing availability under the Credit Facility of $32.7 million, of which we had drawn $24.0 million, leaving $7.9 million available for borrowing, after accounting for the letter of credit. Along with an unrestricted cash balance of $18.7 million, we had total cash and available borrowing capacity of $26.6 million as of December 31, 2013. Approximately $3.8 million of the unrestricted cash balance relates to our Mexican subsidiaries. Standby letters of credit up to a maximum of $5.0 million may be issued under the Credit Facility of which $0.8 million were issued at December 31, 2013. 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, pay dividends or make other restricted payments without bank approval, create liens, make investments, make acquisitions, engage in mergers, change the nature of our business and engage in certain transactions with affiliates. In addition, if the Company's availability under the Credit Facility falls below $6.0 million (or $8.0 million for a period of 5 or more consecutive days), the Company must maintain a fixed charge coverage ratio of at least 1.15 to 1.00.

We also had purchase commitments totaling approximately $6.1 million at December 31, 2013, primarily for manufacturing equipment and inventory.

There are numerous risks and uncertainties relating to the global economy and the commercial vehicle and aerospace and defense industries that could materially affect our financial condition, future results of operations and liquidity. These risks and uncertainties could result in decreased sales, limited access to credit, rising costs, increased competition, customer or supplier bankruptcies, delays in customer payment terms and acceleration of supplier payments, growing inventories and failure to meet debt covenants.

Our ability to service our indebtedness will require a significant amount of cash. Our ability to generate this cash will depend largely on future operations. Based upon our current level of operations and our 2014 business plan, we expect to be able to meet the financial covenants of our Credit Facility and have sufficient liquidity to finance our operations for at least the next twelve months. However, changing business, regulatory and economic conditions may mean that actual results will vary from our forecasts.

Financial Condition

Operating Activities. Net cash used in operating activities was $0.3 million in 2013, as compared to $4.9 million in 2012. Cash of $1.7 million was used to finance an increase in inventory, primarily to support higher volumes during the fourth quarter of 2013 within our Industrial Group as compared to the fourth quarter of 2012. Additionally, increases in accounts payable provided cash of $0.7 million.

Investing Activities. Net cash used in investing activities was $2.8 million in 2013 as compared to $0.6 million in 2012. Net cash used in investing activities for 2013 included $5.1 million of capital expenditures partially offset by proceeds of $2.3 million from the sale of idle assets primarily within the Industrial Group. Net cash used in investing activities in 2012 includes capital expenditures of $7.1 million partially offset by proceeds from the sale of assets of $4.6 million and $1.9 million from the sale of marketable securities.