SYPRIS SOLUTIONS INC
Form 10-K
March 10, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark one)

x **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. For the fiscal year ended December 31, 2007.**

¨ **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:

Common Stock, $.01 par value

(Title of Class)

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 x 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 x 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. x 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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

¨ Large accelerated filer x Accelerated filer ¨ Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes x 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 29, 2007) was $79,382,931.

There were 19,347,675 shares of the registrant s common stock outstanding as of March 5, 2008.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Stockholders to be held April 22, 2008 are incorporated by reference into Part III to the extent described therein.

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

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PART I

Item 1. Business

General

We are a diversified provider of outsourced services and specialty products. We perform a wide range of manufacturing, engineering, design, testing and other technical services, typically under multi-year, sole-source contracts with corporations and government agencies in the markets for aerospace & defense electronics, truck components & assemblies, and for users of test & measurement equipment.

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

Truck Components & Assemblies. We are a significant supplier of forged and machined drive train components for medium and heavy-duty trucks in North America. We produce drive axle shafts, gear sets, differential cases, steer axle forgings, and other components under multi-year, sole-source contracts with ArvinMeritor, Inc. (ArvinMeritor) and Dana Holding Corporation (Dana or DAN), 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 ArvinMeritor 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), Trailmobile Corporation (Trailmobile), Utility Trailer Manufacturing Company (Utility) and Wabash National Corporation (Wabash). Additionally within the light vehicle market, we supply Dana with full float tubes and we currently supply Ford with axle shafts for the F150, F250, F350 and Ranger series pickup trucks, the Expedition, Lincoln Navigator and the Mustang GT. We continue to support our customers strategies to outsource non-core operations by supplying additional components and providing additional value added operations for drive train assemblies. Our truck components & assemblies business accounted for approximately 60% of net revenue in 2007.

Aerospace & Defense Electronics. We are an established supplier of manufacturing services for the production of complex circuit cards, high-level assemblies and subsystems. We have historically had long-term relationships with many of the leading aerospace & defense contractors, including Boeing Company (Boeing), General Dynamics Corporation (General Dynamics), Honeywell International, Inc. (Honeywell), Lockheed Martin Corporation (Lockheed), Northrop Grumman Corporation (Northrop Grumman) and Raytheon Company (Raytheon). We currently manufacture complex circuit card assemblies under multi-year contracts with Raytheon for programs involving a missile guidance system and an air defense network, and under a multi-year contract with Honeywell for main color display systems in the cockpit of a military aircraft. We also have a long-term relationship with the United States (U.S.) Government to design and build secure communications equipment and encryption devices. The defense budget for fiscal 2008 contains provisions to increase spending for space, smart weapons, surveillance, intelligence and secure communications, areas for which we have long provided essential services and products; however, funds were diverted in 2006 and 2007 to finance the armed forces and related equipment and expendable supplies for the war in Iraq, and we expect this to continue throughout 2008. Our aerospace & defense electronics business accounted for approximately 24% of net revenue in 2007.

Test & Measurement Services. We provide technical services for the calibration, certification and repair of test & measurement equipment in and outside the U.S. We are the incumbent supplier for a multi-year contract with the Federal Aviation Administration (FAA) to calibrate and certify the equipment that is used to maintain the radar systems and directional beacons at over 490 sites in the U.S., the Caribbean and the South Pacific. The Company anticipates that this contract will be awarded for another five year term in April, 2008. We also have a

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contract with the National Weather Service (NWS) to calibrate the equipment that is used to maintain the NEXRAD Doppler radar systems at over 135 advanced warning weather service radar stations in 46 states, the Caribbean and Guam. We also have a multi-year contract with AT&T Corporation (AT&T) to provide calibration and certification services at over 260 of its central and field switching locations. We are seeing continued interest by large companies, such as Eastman Kodak Company (Kodak), Motorola and Delphi Automotive, in awarding multi-year contracts for calibration services in order to accelerate vendor reduction programs and reduce costs. Our test & measurement services business accounted for approximately 11% of net revenue in 2007.

Recent Developments

On March 3, 2006 (Filing Date), the Company s largest customer, Dana, and 40 of its U.S. subsidiaries, filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York. Dana s European, South American, Asia-Pacific, Canadian and Mexican subsidiaries were excluded from the Chapter 11 filing.

On December 6, 2006, an independent arbitrator initially held that Dana had breached certain of its agreements with Sypris by failing to transfer certain volumes of business and by failing to pay the appropriate prices for the volumes that were transferred. As a result, the arbitrator awarded payments to Sypris totaling $1.8 million plus $0.1 million per month on an ongoing basis. On January 29, 2007, this award became final; and accordingly, net revenue in the consolidated statements of operations for the year ended December 31, 2007 includes $2.9 million pertaining to the arbitration award. On July 24, 2007, the Company announced that its wholly-owned subsidiary, Sypris Technologies, Inc., entered into a comprehensive settlement agreement with Dana to resolve all outstanding disputes between the parties, terminate any further arbitration payments and enter into a new long-term supply contract running through 2014. This settlement was approved by the bankruptcy court on August 7, 2007.

Pursuant to the settlement agreement, Dana and the Company have (i) entered into a new, long-term master supply agreement in lieu of the three prior supply contracts, (ii) exchanged production of certain non-core components, (iii) rebalanced production among Company plants to reduce costs for both parties, and (iv) ceased all litigation with regard to prior contract disputes, including the release of Dana from certain committed but undelivered production volumes and termination of the arbitration payments. In addition, Dana provided the Company with an allowed general unsecured non-priority claim in the amount of $89.9 million, which was recorded by the Company at its estimated fair value of $76.5 million.

At December 31, 2007, the Company had deferred $55.8 million associated with the settlement, of which $12.6 million is carried in accrued liabilities and $43.2 million is carried in other liabilities in the consolidated balance sheets. The deferred revenue will be recognized over the term of the new master supply agreement. Approximately $8.9 million related to the settlement agreement was recognized into revenue, of which $7.6 million was reflected in gross profit during the year ended December 31, 2007. Approximately $11.8 million of the settlement recognized as a non-recurring gain was offset by settlement related charges and professional fees.

On December 12, 2007 the bankruptcy court approved Dana s plan of reorganization. Pursuant to the terms included therein, the Company became entitled to receive an initial distribution of approximately 3.1 million shares of common stock in Dana Holding Corporation (DAN), the right to participate in additional distributions of reserved shares of common stock of DAN if certain disputed matters are ultimately resolved for less than DAN s current reserves for those matters (presently estimated by the Company to be 300,000 to 500,000 shares to be received by the Company in 2008 and 2009) and the right to receive cash of approximately $6.3 million by mid-March, 2008, depending on various factors in the administration of Dana s bankruptcy estate. Dana emerged from bankruptcy on January 31, 2008, and on February 1, 2008, the newly issued shares of Dana Holding Corporation began trading on the New York Stock Exchange under the ticker symbol DAN . See Note 2 and Note 20 to the consolidated financial statements for additional information.

Industry Overview

We believe the trend toward outsourcing is continuing across a wide range of industries and markets as outsourcing specialists assume a strategic role in the supply chain of companies of all types and sizes. We expect the growth in outsourcing expenditures to continue increasing at a rate far higher than the expansion in the overall economy.

We believe the trend toward outsourcing is continuing because outsourcing frequently represents a more efficient, lower cost means for manufacturing a product or delivering a service when compared to more vertically integrated alternatives. While the rate of acceptance of the outsourcing model may vary by industry, we believe the following benefits of outsourcing are driving this general trend.

Reduced Total Operating Costs and Invested Capital. Outsourcing specialists are frequently able to produce products and/or deliver services at a reduced total cost relative to that of their customers because of the ability to allocate the expense for a given set of fixed capacity, including assets, people and support systems, across multiple customers with diversified needs. In turn, these outsourcing specialists can achieve higher utilization of their resources and achieve greater productivity, flexibility and economies of scale.

Access to Advanced Manufacturing Capabilities and Processes and Increased Productivity. The ability to use a fixed set of production assets for a number of customers enables outsourcing specialists to invest in the latest technology as a means to further improve productivity, quality and cycle times. The magnitude of these investments can be prohibitive absent the volume and reliability of future orders associated with having a broad array of customers for the use of those assets.

Focus on Core Competencies. Companies are under intense competitive pressure to constantly rationalize their operations, invest in and strengthen areas in which they can add the greatest value to their customers and divest or outsource areas in which they add lesser value. By utilizing the services of outsourcing specialists, these companies can react more quickly to changing market conditions and allocate valuable capital and other resources to core activities, such as research and development, sales and marketing or product integration.

Improved Supply Chain Management. We believe that the trend in outsourcing favors specialists that have the financial, managerial and capital resources to assume an increasingly greater role in the management of the supply chain for the customer. By utilizing fewer and more capable suppliers, companies are able to greatly simplify the infrastructure required to manage these suppliers, thereby reducing their costs, risks and logistical complexity, while improving margins, supply chain reliability, flexibility and long-term strategic planning.

Our Markets

Truck Components & Assemblies. The truck components & assemblies market consists of the original equipment manufacturers, or OEMs, including DaimlerChrysler Corporation, Ford, Freightliner, General Motors Corporation, Mack, Navistar, PACCAR and Volvo, and a deep and 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 Dorsey, Great Dane, Hyundai, Stoughton, Trailmobile, Utility and Wabash. Tier I companies represent the primary suppliers to the OEMs and include ArvinMeritor, Dana, Delphi Automotive Systems Corporation, Eaton Corporation, and Visteon Corporation (Visteon), among others. Many of the Tier I companies are confronted with excess capacity, high hourly wage rates, costly benefit packages and aging capital equipment. 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 & 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.

In an attempt to gain a competitive advantage, many OEMs have been reducing the number of suppliers they utilize. These manufacturers are choosing stronger relationships with fewer suppliers that are capable of investing to support their operations. In response to this trend, many suppliers have combined with others to gain the critical mass required to support these needs. As a result, the number of Tier I suppliers is being reduced, but in many cases, the aggregate production capacity of these companies has yet to be addressed. We believe that as Tier I suppliers seek to eliminate excess capacity, they will increasingly choose outsourcing as a means to enhance their financial performance, and as a result, companies such as Sypris will be presented with new business and acquisition opportunities.

Aerospace & Defense Electronics. The consolidation of defense contractors over the past decade has added to the increased demand for outsourcing specialists. The consolidated companies, some of which have developed highly leveraged balance sheets as a result of mergers and acquisitions, have been motivated to seek new ways to raise margins, increase profitability and enhance cash flow. Accordingly, outsourcing specialists, including Sypris, have been successful in building new relationships with companies that previously relied more on internal resources. We believe this trend will continue, and that our extensive experience, clearances, certifications and qualifications in the manufacturing of aerospace & defense electronics will serve to differentiate us from many of the more traditional outsource suppliers. We also believe that we are well positioned to take advantage of additional outsourcing activity that may flow from the prime contractors that are awarded contracts related to increased defense appropriations and expenditures as a result of increased focus on national defense and homeland security.

The nature of providing outsourced manufacturing services to the aerospace & defense electronics industry differs substantially from the traditional commercial outsourced 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.

Test & Measurement Services. The widespread adoption of the International Organization for Standardization (ISO) and Quality Standards (QS), among others, has been underway for many years. A critical component of basic manufacturing discipline and these quality programs is the periodic calibration and certification of the test and measurement equipment that is used to measure process performance. The investment in this equipment and the skills required to support the calibration and certification process has historically been performed offsite by the manufacturers of the equipment, or onsite by internal operations.

We believe that test & measurement services will be increasingly outsourced to independent specialists who can use the manpower and equipment more efficiently across a diversified base of customers, reduce investment requirements and improve profitability on a national scale.

Our Business Strategy

Our objective is to improve our leadership position in each of our core markets by increasing the 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 the principal supplier of medium and heavy-duty truck axle shafts in North America. We have been an established supplier of manufacturing and technical services to major aerospace & defense companies and agencies of the U.S. Government for over 40 years. We are also the sole provider of calibration, certification and repair services for equipment used by the FAA and the sole provider of similar services under a multi-year agreement with the NWS of the U.S. Department of Commerce s National Oceanic & Atmospheric Administration (NOAA). We will continue to focus on those markets where we have the expertise, qualifications and leadership position to sustain 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. ArvinMeritor and Dana have awarded us with sole-source supply agreements for certain parts that run as long as through 2013 and 2014, respectively. Historically, we entered into multi-year manufacturing services agreements with Boeing, Honeywell, Lockheed Martin, Northrop Grumman and Raytheon. 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 will have additional growth opportunities with these and other customers.

Pursue the Strategic Acquisition of Assets. We will continue to pursue the strategic acquisition of assets that serve to consolidate our position of leadership in our core markets, expand our presence outside North America, create or strengthen our relationships with leading companies and expand our range of value-added services in return for multi-year supply agreements. Since these assets are integrated with our core businesses, we generally are able to use these assets 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 will continue to grow through the addition of new value-added manufacturing capabilities and the introduction of additional components in the supply chain

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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 truck components & assemblies market that enable us to reduce labor and shipping costs and minimize cycle times for our customers over the long-term, providing us with significant additional growth opportunities in the future. Migrating from design and manufacturing of complex circuit card assemblies to box builds will increase product content with our customers and allow us to be a more significant player in the aerospace & defense segment.

Invest to Increase our Competitiveness. We will continue to invest in advanced manufacturing and process technologies to reduce the cost of the services we provide for our customers on an ongoing basis. We continue to expand and automate the services we provide to our customers in the truck components & assemblies market, with approximately $142 million invested from 2000 to 2007. We believe our ability to leverage this capability across a number of customers in the future will further improve our capacity utilization, absorption of overhead and reduce our manufacturing costs.

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 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 exceed the scope of many manufacturing service companies, including software 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 toward the development and production of our own product line of high assurance security components, including cryptographic key management programs and data encryption 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.

Truck Components & Assemblies:

ArvinMeritor	Axle shafts and drive train components for medium and heavy-duty trucks as well as axle beams for trailers.
Axle Alliance	Axle shafts for heavy-duty trucks.
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.
Ford	Axle shafts for Mustangs, light-duty trucks and super-duty trucks.
Traxle	Axle shafts for heavy-duty trucks.
Aerospace & Defense Electronics:	
Honeywell	Complex circuit cards for the color display systems used in military aircraft.
U.S. Government	Encryption devices, secure communications equipment and recording systems.
Raytheon	Complex circuit cards for use in a missile guidance system and an integrated air defense network.

Test & Measurement Services:

AT&T	Calibration and certification at over 260 central and field switching locations.
Federal Aviation Administration	Calibration and certification at over 490 airports or airways facilities.
Lockheed Martin	Testing of electronic components for space and defense applications.
National Weather Service	Calibration and certification for over 135 advanced warning weather radar stations.

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, statistical process control, 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 of our customers. 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 & 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 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, materials procurement, system assembly, testing and final system configuration. Our manufacturing services contracts for the aerospace & defense electronics market are generally sole-source by part number.

Technical Services

Test & Measurement Services. We calibrate, repair and certify the test and measurement equipment that is used to maintain wireless communication equipment, control tower radar and direction beacons, NEXRAD Doppler advanced warning weather service radar systems, digital oscilloscopes, microwave equipment and fiber optic measuring equipment, among others. The applications cover the maintenance of cellular communications systems, air traffic control systems, broadband telecommunication systems and quality certification programs in manufacturing operations. We also perform a wide-range of testing services on a contract basis, including radio frequency, microwave and mixed signal component testing, environmental testing, dynamics testing and failure analysis, among others.

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, magnetic meters and sensors used in commercial and laboratory environments and high-pressure closures and joints used in pipeline and chemical systems. As we look to grow our business, emphasis will be placed on 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 offering. Our five largest customers in 2007 were Dana, ArvinMeritor, Ford, Honeywell and Raytheon, which accounted for 61% of net revenue in 2007. Our five largest customers in 2006 and 2005 were Dana, ArvinMeritor, Ford, Traxle and Raytheon. These five customers accounted for 70% and 67% of net revenue in 2006 and 2005, respectively. More specifically, for the year ended December 31, 2007, Dana and ArvinMeritor represented approximately 34% and 15% of our net revenue, respectively. Similar amounts for the 2006 and 2005 years ended for Dana were 41% and 39%, respectively, while ArvinMeritor was 19% in 2006 and 15% for 2005. In addition, U.S. governmental agencies accounted for 12%, 8% and 9% of net revenue in 2007, 2006 and 2005, respectively.

Geographic Areas

Our operations are domiciled in the U.S. and Mexico. Our Mexican subsidiaries and affiliates are primarily 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. 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.

Consolidated non-U.S. net revenues were $53.6 million, or 12%, and $86.2 million, or 17%, of our consolidated net revenues in 2007 and 2006, respectively. Similar amounts for 2005 were $68.7 million, or 13% of our consolidated net revenue. In 2007, 2006, and 2005, our non-U.S. net income was $1.7 million, $5.8 million and $4.9 million, respectively, as compared to a consolidated net loss of $2.1 million and $1.4 million in 2007 and 2006, respectively, and net income of $5.3 million in 2005. You can find more information about our regional operating results in Note 18 Segment Information in Item 8 of this 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 participation 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, reducing the amount of set-up time or material that may be required to produce the product, or by developing software that can automate the test and/or certification process. The award of contracts or programs can be a lengthy process, which in some circumstances can extend well beyond 12 months.

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.

Backlog

Our order backlog at December 31, 2007 was $106.9 million as compared to order backlog at December 31, 2006 of $99.5 million. Backlog for the Aerospace & Defense segment and the Test & Measurement segment at December 31, 2007 was $99.1 million and $7.8 million, respectively. Backlog for the Aerospace & Defense segment and the Test & Measurement segment at December 31, 2006 was $94.0 million and $5.5 million, respectively. Backlog consists of purchase orders with scheduled delivery dates and quantities. Total backlog at December 31, 2007 included $86.1 million for orders that are expected to be filled within 12 months. Our backlog has varied from quarter to quarter and may vary significantly in the future as a result of the timing of significant new orders and/or shipments, order cancellations, material availability and other factors.

Competition

The outsourced manufacturing services 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

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components & assemblies market, we compete primarily against companies including Mid-West Forge, Inc., Spencer Forge and Machine, Inc. and Traxle, that serve as suppliers to many Tier I and smaller companies. In the aerospace & defense electronics market, we compete primarily against companies including Jabil Circuit, Inc., LaBarge, Inc., Primus Technologies Corporation, Sparton Corporation and Teledyne Technologies Incorporated. In the test & measurement services market, we compete primarily against companies including SIMCO Electronics, Transcat, Inc., Davis Inotek Instruments, and a variety of small, local, independent laboratories. We may face new competitors in the future as the outsourcing industry evolves and existing or start-up companies develop capabilities similar to ours.

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 are larger and have greater financial and operating resources than we do. Some of our competitors have greater geographic breadth and range of services 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. We believe our competitive position to be good, and the barriers to entry to be high in a significant portion of the markets we serve.

Suppliers

For the majority 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 primarily 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. For a smaller portion 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 & assemblies business. We purchase the majority 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 & 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. We invested $2.8 million, $2.0 million and $2.8 million in research and development in 2007, 2006 and 2005, respectively.

Patents, Trademarks and Licenses

We own and are licensed under a number of patents and trademarks that we believe are sufficient for our operations. 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, both in the U.S. and in Mexico, including regulations concerning financial reporting and controls, labor relations, 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 at several of our locations. 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 any of our facilities, there can be no assurance that the approved status of our facilities 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 our properties, 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, 2007, we had a total of approximately 2,149 employees, 1,773 engaged in manufacturing and providing our technical services, 46 engaged in sales and marketing, 132 engaged in engineering and 198 engaged in administration. Approximately 883 of our employees are covered by collective bargaining agreements with various unions that expire on various dates through 2009. Excluding certain Mexico employees covered under an annually ratified agreement, collective bargaining agreements covering 240 employees are subject to renewal in the next 12 months. Although we believe overall that our 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.

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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, potential acquisitions or financial results and our views about developments beyond our control including 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, even if, for example, they remain available on our website after our outlook has changed. 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

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. For contracts to which we apply the percentage of completion accounting method, revisions to our cost estimates could reduce our operating results in later periods.

A material portion of our business is conducted under multi-year contracts, which generally include fixed prices or periodic price reductions without minimum purchase requirements. Our financial results are at greater risk when we must 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 few years, we have signed long-term supply agreements with Dana and ArvinMeritor and acquired their facilities in Morganton, North Carolina, Kenton, Ohio 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, our long-term pricing agreements could generate lower margins than anticipated and there can be no assurance that we will successfully integrate these operations. In addition, our failure to identify potential liabilities with respect to certain indemnified environmental and other conditions, or our assertion of related claims, could adversely affect our operating results or our customer relationships. Our efforts to restructure, relocate and consolidate a significant number of the operations in these 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.

If customers seek bankruptcy protection, as Dana did on March 3, 2006, they could act to terminate all or a portion of their business with us, originate new business with our competitors and terminate or assign our long-term supply agreements. Any loss of revenue from our major customers, including the non-payment or late payment of our invoices, 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 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. If we receive unanticipated orders, 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 2007 were Dana, ArvinMeritor, Ford, Honeywell and Raytheon, collectively accounting for 61% of net revenue. Our five largest customers in 2006 and 2005 were Dana, ArvinMeritor, Ford, Traxle and Raytheon, collectively accounting for 70% and 67% of net revenue in 2006 and 2005, respectively. The truck components & assemblies industry has experienced credit risk, highly cyclical market demand, labor unrest, rising steel costs, bankruptcy and other obstacles, while the aerospace & defense electronics industry has seen consolidation, increased competition 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 general conditions could harm our operating results. The truck components & assemblies market is highly cyclical, due in part to regulatory deadlines and is expected to remain flat at historically low levels in 2008.

Rising costs of steel or component parts have increased our inventory and working capital levels and presented challenges to our automotive 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 & defense industry is pressured by cyclicality, technological change, shortening product life cycles, decreasing margins, unpredictable funding levels and government procurement processes. Any of these factors, particularly in our secured electronic communications or missile programs, could impair our business model.

As of March 3, 2008, we had provided approximately $15.3 million, net of payables, in combined trade credit exposure to ArvinMeritor, Dana and Ford, each of which currently carries at least one non-investment grade credit rating on its unsecured debt, indicating a high potential risk of default. 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 can reduce our government sales.

We sell manufacturing services and products to a number of U.S. government agencies, which in the aggregate represented approximately 12%, 8%, and 9% of our net revenue in 2007, 2006 and 2005, respectively. We also serve as a contractor for large aerospace & defense companies such as Boeing, Honeywell, Lockheed Martin, Northrop Grumman and Raytheon, typically under federally funded programs, which represented approximately 8%, 7% and 9% of net revenue during 2007, 2006 and 2005, 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. 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. 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. 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 reduce 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

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

If we are unable to improve the cost, efficiency and yield of our operations, our costs could increase and our financial results could decline. A number of major obstacles could include: inflationary pressures; 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 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; or 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. 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.

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

Our growth strategy includes acquiring complementary businesses. We could fail to identify, finance or complete suitable acquisitions on acceptable terms and prices. Acquisition efforts could increase 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, including 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.

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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 have greater financial and organizational resources, 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. 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.

Access to Capital

An inability to obtain favorable financing could impair our growth.

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. 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 grow this business. 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 current 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.

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.

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A permanent decline in the value of Dana Holding Corporation could adversely affect our business.

The approval of Dana s reorganization plan by the U.S. bankruptcy court in the Southern District of New York on December 12, 2007 finalized our right to receive certain distributions, including distributions of common stock in DAN. We have recorded the aggregate value of such distributions at $76.5 million. A substantial portion of the current owners of DAN common stock are contractually restricted from trading those shares for at least six months after the confirmation date, and many equity mutual funds are restricted from purchasing stock in businesses that have recently emerged from bankruptcy. Due to such factors, among others, we believe that the trading value of DAN common stock on the New York Stock Exchange is likely not to reflect the longer-term value of DAN for a number of months. However, if the trading value of DAN common stock remains below our aggregate recorded valuation of such stock, our business, results of operations and financial condition could be materially adversely impacted. See Notes 2 and 20 to the financial statements in Item 8 of this Form 10-K for additional information.

Contract Terminations

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, 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 terminated or not renewed, we would lose substantial revenues and our operating results as well as prospects for future business opportunities could be adversely affected.

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.

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 could have a material adverse effect on our operations. Our future success will also require an ability to attract and retain qualified employees. 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, 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 883 employees, or approximately 41% of total employees, of which agreements covering 240 employees are subject to renewal in the next 12 months. Although we believe that our overall relations with our labor unions are positive, 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.

Deferred Tax Assets

Our lack of profitability in the U.S. or other factors could adversely affect our financial results.

Our operations in the U.S., considered apart from our other operations in Mexico, have generated net operating losses in recent years. If these losses were to continue or if permanent or temporary differences occur between the recognition of revenues or expenses for tax purposes in comparison to GAAP financial reporting purposes, then our balance sheet, revenues, profitability and cash flows could be adversely impacted.

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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. Although we typically receive environmental indemnification agreements from previous owners of these facilities, there is no assurance that the indemnifications of former owners will be adequate to protect us from liability.

Our Marion, Ohio facility 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. We continue to test and assess this site to determine the extent of this 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, certain environmental conditions that existed on the site as of closing and as to which we notified Dana prior to December 31, 2002, subject to certain other conditions involving Dana s release of, or continuing right to seek indemnity from, Eaton Corporation, from which Dana acquired the property.

A leased facility we formerly occupied in Tampa, Florida is subject to remediation activities related to groundwater contamination involving methyl chloride and other volatile organic compounds, which occurred prior to our use of the facility, and such contamination extends beyond the boundaries of the facility. The prior operator of the facility has entered into a consent order with the State of Florida and agreed to remediate the contamination, the full scope of which has not yet been determined. In addition, certain claims which have been made against the Company and the former owners or operators of the facility have been fully indemnified by such former owners and operators, who have assumed the defense of such claims.

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. Under our purchase agreement for this facility, Dana had 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 December 31, 2005. However, such amounts due from Dana have been released in conjunction with Dana s Chapter 11 filing and the Company s comprehensive settlement with Dana. 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 Corporation, from which Dana acquired the property.

Our Kenton, Ohio facility 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 Heavy Vehicle Systems agreed to indemnify us for, among other things,

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environmental conditions that existed on the site as of closing and as to which we notified ArvinMeritor prior to May 2, 2006.

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, political uncertainties or natural disasters 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 & 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; risks relating to natural disasters or other casualties; 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.

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Item 2. Properties

Our principal manufacturing services operations are engaged in electronics manufacturing services for our aerospace & defense customers and industrial manufacturing services for our truck components & 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	Market Served	Own or Lease (Expiration)	Approximate Square Feet	Certifications
Corporate Office:				
Louisville, Kentucky		Lease (2014)	21,600	
Manufacturing and Service Facilities:				
Kenton, Ohio	Truck Components & Assemblies	Own	550,000	TS 16949
Louisville, Kentucky	Truck Components & Assemblies	Own	450,000	QS 9000
Marion, Ohio	Truck Components & Assemblies	Own	255,000	TS 16949
Morganton, North Carolina	Truck Components & Assemblies	Own	360,000	TS 16949 ISO 14001
Orlando, Florida	Test & Measurement Services	Own	62,000	ANSI/NCSL Z540 AS 9100 DSCC FCC ISO 9001 ISO 17025/Guide 25 MIL-STD 750, 883, 202 and 810 VCCI
San Dimas, California	Aerospace & Defense Electronics	Lease (2015)	26,300	ISO 9001
Tampa, Florida	Aerospace & Defense Electronics	Lease (2016)	318,000	ISO 9001 AS 9100 NASA-STD-8739

				IPC-A-610, Rev D, Class 3 J-STD-001, Rev D, Class 3
Toluca, Mexico	Truck Components & Assemblies	Own	217,000	TS 16949

In addition, we lease space in 20 other facilities primarily utilized to provide technical services, all of which are located in the U.S. We also own 12 ISO-certified mobile calibration units and five ISO-certified transportable field calibration units that are utilized to provide test & measurement services at customer locations throughout the U.S., the Caribbean and the South Pacific.

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

Certification/Specification	Description
ANSI/NCSL Z540	A certification which sets out general provisions that a laboratory must address to carry out specific calibrations or tests and provides laboratories with direction for the development of a fundamental quality management system.
AS 9100	A quality management system developed by the aerospace industry to measure supplier conformance with basic common acceptable aerospace quality requirements.
DSCC	A certification that specifies specific functions or processes that are conducted in compliance with military specifications, such as a quality program, high-reliability soldering, component testing, and environmental testing.
FCC	A certification process by the Federal Communications Commission, which sets out general provisions that a laboratory must conform to in carrying out EMI/EMC testing and provides laboratories with direction for the development of a fundamental quality management system.
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.
J-STD-001	A family of voluntary standards of industry-accepted workmanship criteria for electronics assemblies.
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.
ISO 17025/Guide 25	A certification process commonly referred to as A2LA, which sets out general provisions that a laboratory must address to carry out specific calibrations or tests and provides laboratories with direction for the development of a fundamental quality management system.
MIL	A specification that signifies specific functions or processes that are conducted in compliance with military specifications, such as a quality program, high-reliability soldering, calibration and metrology, and environmental testing.
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.

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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.
VCCI	An internationally recognized and accepted Japanese certification by the Voluntary Control Council for Interference, which established regulations to control interference with licensed radio communication services in accordance with CISP 22 emission standards in carrying out EMI/EMC testing and is similar to FCC certification.

Item 3. Legal Proceedings

We are involved from time to time in routine 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:

Our Marion, Ohio facility 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. 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 December 31, 2002, to the extent of any indemnification owed to Dana by Eaton Corporation or any other matters for which Dana has released Eaton.

A leased facility we formerly occupied in Tampa, Florida is currently subject to remediation activities related to groundwater contamination involving methylene chloride and other volatile organic compounds which occurred prior to our use of the facility. The contamination extends beyond the boundaries of the facility. In December 1986, Honeywell, a prior operator of the facility, entered into a consent order with the Florida Department of Environmental Regulation under which Honeywell agreed to remediate the contamination, the full scope of which has not yet been determined. We purchased the assets of a business formerly located on this leased site and operated that business from 1993 until December 1994. Philips Electronics, the seller of those assets, has agreed to indemnify us with respect to environmental matters arising from groundwater contamination at the site prior to our use of the facility. On November 3, 2004, Sypris Electronics was served as a co-defendant with Honeywell International, Inc. and Phillips Electronics America Corporation in an environmental lawsuit filed in the Circuit Court of the Thirteenth Judicial Circuit Hillsborough County, Florida by Helen Jones and other surrounding landowners, alleging various damages caused by such contamination. Philips Electronics has agreed to pay for our defense costs.

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

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of any indemnification owed to Dana by Eaton Corporation or any other matters for which Dana has released Eaton.

Our Kenton, Ohio facility 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 Heavy Vehicle Systems 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 ArvinMeritor prior to May 2, 2006.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 31, 2007.

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PART II

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

Our common stock is traded on the Nasdaq National 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 National Market.

	High	Low
Year ended December 31, 2006:		
First Quarter	$ 11.26	$ 9.04
Second Quarter	10.10	7.83
Third Quarter	9.99	6.94
Fourth Quarter	8.35	6.77
Year ended December 31, 2007:		
First Quarter	$ 7.14	$ 6.03
Second Quarter	8.87	6.46
Third Quarter	9.05	7.90
Fourth Quarter	9.91	5.53

The graph above shows a comparison of cumulative total stockholder returns for Sypris, calculated on a dividend reinvestment basis, from December 31, 2002 through December 31, 2007. In the performance graph, the cumulative total stockholder return of the Company is compared to the Russell 2000 Index and the S&P SmallCap 600 Index. The S&P SmallCap 600 Index has been selected as a basis of comparison since Sypris believes the S&P

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SmallCap 600 Index more appropriately tracks the performance of multi-industry businesses at its level of market capitalization, than any identifiable peer group.

As of March 5, 2008, there were 911 holders of record of our common stock. On September 22, 2002, our Board of Directors declared an initial quarterly cash dividend of $0.03 per common share outstanding. Cash dividends of $0.03 per common share have been paid quarterly since the initial dividend was declared in 2002. Dividends may be paid on common stock only when, as and if declared by our Board of Directors in its sole discretion. We did not repurchase any of our common stock during the fourth quarter of the fiscal year ended December 31, 2007.

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Item 6. Selected Financial Data

The following selected financial data should be read in conjunction with the Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and related notes included in Item 8 of this Form 10-K. The selected financial data set forth below as of December 31, 2007 and 2006, and for the three years included in the period ended December 31, 2007 are derived from our audited consolidated financial statements included elsewhere in this Form 10-K, and the data below are qualified by reference to those consolidated financial statements and related notes. The financial statement data at December 31, 2005, 2004 and 2003 and for the years ended December 31, 2004 and 2003 are derived from our audited consolidated financial statements not included in this Form 10-K.

	Years Ended December 31, (in thousands, except per share data)				
	2007	**2006(1)**	**2005**	**2004(2)**	**2003(3)**
Consolidated Statement of Operations Data:					
Net revenue	$ 435,915	$ 497,664	$ 522,766	$ 425,402	$ 276,605
Cost of sales	396,119	456,574	471,428	371,963	230,660
Gross profit	39,796	41,090	51,338	53,439	45,945
Selling, general and administrative	40,517	37,107	35,669	35,248	26,711
Research and development	2,821	1,988	2,833	3,697	4,166
Amortization of intangible assets	527	645	614	596	194
Nonrecurring (income) expense, net	(3,246)	1,485			
Operating (loss) income	(823)	(135)	12,222	13,898	14,874
Interest expense, net	3,685	3,708	5,979	2,100	1,693
Other expense (income), net	31	(387)	(1,325)	(138)	230
(Loss) income before income taxes	(4,539)	(3,456)	7,568	11,936	12,951
Income tax (benefit) expense	(2,400)	(2,094)	2,247	3,637	4,860
Net (loss) income	$ (2,139)	$ (1,362)	$ 5,321	$ 8,299	$ 8,091
(Loss) earnings per common share:					
Basic	$ (0.12)	$ (0.08)	$ 0.30	$ 0.48	$ 0.57
Diluted	$ (0.12)	$ (0.08)	$ 0.29	$ 0.47	$ 0.56
Cash dividends per common share	$ 0.12	$ 0.12	$ 0.12	$ 0.12	$ 0.12
Shares used in computing per share amounts:					
Basic	18,231	18,079	18,016	17,119	14,237
Diluted	18,231	18,079	18,323	17,745	14,653

	December 31, (in thousands)				
	2007	**2006(1)**	**2005**	**2004(2)**	**2003(3)**
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 14,622	$ 32,400	$ 12,060	$ 14,060	$ 12,019
Working capital	152,441	100,717	111,765	143,123	81,456
Total assets	422,060	379,033	417,624	431,178	264,435
Current portion of long-term debt	5,000	5,000		7,000	3,200
Long-term debt, net of current portion	60,000	55,000	80,000	110,000	53,000
Total stockholders equity	207,479	209,886	213,734	208,939	145,392

(1) Effective January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* under the modified prospective method. We also adopted SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)* as of December 31, 2006. See Note 1 of our consolidated financial statements.

(2)

On May 3, 2004 and June 30, 2004, respectively, we completed the acquisition of the net assets of ArvinMeritor s Kenton, Ohio facility and Dana s Toluca, Mexico facility and their results of operations and related purchased assets are included from those dates forward.

(3) On December 31, 2003, we completed the acquisition of the net assets of Dana s Morganton, North Carolina facility and its results of operations and related purchased assets are included from that date forward.

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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 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 Risk Factors and elsewhere in this Form 10-K.

Overview

We are a diversified provider of outsourced services and specialty products. We perform a wide range of manufacturing, engineering, design, testing and other technical services, typically under multi-year, sole-source contracts with major companies and government agencies in the markets for aerospace & defense electronics, truck components & assemblies, and test & measurement services. Revenue from our three core markets accounted for approximately 95% of our revenue for the year ended December 31, 2007, while revenue from our outsourced services accounted for approximately 81% of our revenue.

We are organized into two business groups, the Industrial Group and the Electronics Group. The Industrial Group is one reportable business segment, while the Electronics Group includes two reportable business segments, Aerospace & Defense and Test & Measurement. The Industrial Group is comprised of Sypris Technologies, Inc. and its subsidiaries, which generates revenue primarily from the sale of manufacturing services to customers in the market for truck components & assemblies and from the sale of products to the energy and chemical markets. The Aerospace & Defense reportable segment is comprised of Sypris Data Systems, Inc. and Sypris Electronics, LLC. Revenue for this group is derived primarily from the sale of manufacturing services, technical services and products to customers in the market for aerospace & defense electronics. The Test & Measurement reportable segment consists solely of Sypris Test & Measurement, Inc., which generates revenue primarily from providing technical services for the calibration, certification and repair of test and measurement equipment in the U.S.

Our objective is to become the leading outsourcing specialist in each of our core markets for aerospace & defense electronics, truck components & assemblies, and test & measurement services. We have focused our efforts on establishing long-term relationships with industry leaders who embrace multi-year contractual relationships as a strategic component of their supply chain management.

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 estimates 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.

Impairments. Goodwill is tested at least annually for impairment by calculating the estimated fair value of each business with which goodwill is associated. The estimated fair value is based on a discounted cash flow analysis that requires judgment in our evaluation of the business and establishing an appropriate discount rate and terminal value to apply in the calculations. In selecting these and other assumptions for each business, we consider historical performance, forecasted operating results, general market conditions and industry considerations specific to the business. It is possible that the assumptions underlying the impairment analysis will change in such a manner that impairment charges may occur. We likely would compute a materially different fair value for a business if different assumptions were used or if circumstances were to change.

At December 31, 2007, net assets of our Test & Measurement segment were $13.4 million, including goodwill of $6.9 million, and our Aerospace & Defense segment had net assets of $41.5 million, including goodwill of $6.9 million. If continued improvements in operations are not achieved and profitability deteriorates, we may be required to record an impairment charge to goodwill for the Test & Measurement and/or the Aerospace & Defense segments.

Long-term Contracts. A large part of our Aerospace & Defense segment business is derived from long-term contracts for development, production and service activities, which we account for consistent with the American Institute of Certified Public Accountants (AICPA) audit and accounting guide, Audits of Federal Government Contractors, the AICPA s Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, and other relevant revenue recognition accounting literature, as applicable. We consider the nature of these contracts and the types of products and services provided when we determine the proper accounting for a particular contract.

Primarily, we record long-term, fixed-price contracts on a percentage of completion basis using units-of-delivery to measure progress toward completing the contract and recognizing net revenue. Revenue is recognized on these contracts when units are shipped or delivered to the customer, as applicable, with unit revenue based upon unit prices as set forth in the applicable contracts. The costs attributed to contract revenue are based upon the estimated average costs of all units to be shipped. For example, we use this method of revenue recognition on our encryption programs. In less frequent circumstances, we enter into milestone specific, fixed-price contracts for which revenue is recorded when we achieve performance milestones. Revenue recognized under such milestones is limited to net revenue that we would recognize under the cost-to-cost method. Under the cost-to-cost method of accounting, revenue is recognized based on the ratio of costs incurred to our estimate of total costs at completion. For example, we use this methodology for our CEC, Common Card and KI-17 programs. As we incur costs under cost-reimbursement-type contracts, we record net revenue. Cost-reimbursement-type contracts include time and materials and other level-of-effort-type contracts. An example of this type of revenue recognition includes the Information Assurance Engineering Services program.

As a general rule, we recognize net revenue and profits earlier in a production cycle when we use the cost-to-cost and milestone methods of percentage of completion accounting than when we use the units-of-delivery method. In addition, our profits and margins may vary materially depending on the types of long-term government contracts undertaken, the costs incurred in their performance, the achievement of other performance objectives, and the stage of performance at which the right to receive fees is finally determined.

Contract accounting requires judgment relative to assessing risks, estimating contract revenue and costs, and making assumptions for schedule and technical issues. Due to the size and nature of many of our contracts, the estimation of total revenue and cost at completion is complicated and subject to many variables. Contract costs include material, labor and subcontracting costs, as well as an allocation of indirect costs. Assumptions have to be made regarding the length of time to complete the contract because costs also include expected increases in wages and prices for materials. For contract change orders, claims or similar items, we apply judgment in estimating the amounts and assessing the potential for realization. These amounts are only included in contract value when they can be reliably estimated and realization is considered probable.

The majority of our Aerospace & Defense segment net revenue is driven by pricing based on costs incurred to produce products or perform services under contracts with the U.S. Government, and therefore not necessarily on market-based factors. Cost-based pricing is determined under the Federal Acquisition Regulations (FAR). The FAR provides guidance on the types of costs that are allowable in establishing prices for goods and services under U.S. Government contracts. For example, costs such as those related to charitable contributions, advertising, public relations and interest expense are unallowable, and therefore, not recoverable through net revenue.

Approximately 19%, 12% and 16% of total net revenue was recognized under the percentage of completion method based on units of delivery during 2007, 2006 and 2005, respectively. Approximately 2%, 3% and 2% of total net revenue was recognized under the percentage of completion method based on milestones or cost-to-cost during 2007, 2006 and 2005, respectively. Therefore, the amounts we record in our consolidated financial statements using contract accounting methods and cost accounting standards are material. Because of the significance of the judgments and estimation processes, it is likely that materially different amounts could be recorded if we used different assumptions or if the underlying circumstances were to change. When adjustments in estimated contract revenues or costs are required, any changes from prior estimates are generally included in earnings in the current period. We closely monitor compliance with and the consistent application of our critical accounting policies related to contract accounting. In addition to less formal monthly reviews, management in the Aerospace & Defense segment formally assesses the status of contracts on a quarterly basis through extensive estimate at completion reviews, which include multiple levels of program personnel. Costs incurred and allocated to contracts with the U.S. Government are reviewed for compliance with regulatory standards by our personnel and are subject to audit by the Defense Contract Audit Agency.

Pension Plan Funded Status. The calculation of pension assets and liabilities involve complex estimation processes based on third party actuarially determined estimates, which rely on management estimates of the discount rate and rate of return on plan assets. Changes in these rates could significantly impact the actuarially determined amounts recorded in the statements of financial position.

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. The Company accounts for income taxes as required by the provisions of Statement of Financial Accounting Standard (SFAS) No. 109, *Accounting for Income Taxes* (SFAS No. 109), 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.

As referenced in Note 16 to the consolidated financial statements, the Company adopted FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48), as of January 1, 2007. Management judgment is required in determining income tax expense and the related balance sheet amounts. In addition, under FIN 48 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. The Company believes that its recorded 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, SFAS No. 109 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 the Company conducts its operations or otherwise incurs taxable income or losses. In the U.S., the Company had a net deferred tax liability at December 31, 2007. U.S. operations have not been profitable in recent years, however. If unprofitable results continue, we may be required to record a valuation allowance on the resulting deferred tax assets. The Company s foreign operation had a net deferred tax asset at December 31, 2007. The Company has been profitable in its foreign operations and anticipates continuing profitability in the future. No valuation allowances were recorded during 2007, 2006 or 2005.

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Results of Operations

The tables presented below, which compare our consolidated results of operations from one year to another, present 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 data columns in each table show the absolute results for each year 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 year to the next, that change is shown as a positive number in both columns. Conversely, when expenses increase from one year to the next, that change is shown as a negative number in both columns. The last two columns in each table show the results for each period as a percentage of net revenue. In these two columns, the cost of sales and gross profit for each are given as a percentage of that segment s net revenue. These amounts are shown in italics. In addition, as used in these tables, NM means not meaningful.

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

	Year Ended December 31,		Year Over Year Change Favorable (Unfavorable)	Year Over Year Percentage Change Favorable (Unfavorable)	Result as Percentage of Net Revenue for the Year Ended December 31,	
	2007	2006			2007	2006
			(in thousands, except percentage data)			
Net revenue:						
Industrial Group	$ 279,082	$ 364,570	$ (85,488)	(23.4)%	64.0%	73.2%
Aerospace & Defense	104,505	87,491	17,014	19.4	24.0	17.6
Test & Measurement	52,328	45,603	6,725	14.7	12.0	9.2
Electronics Group	156,833	133,094	23,739	17.8	36.0	26.8
Total net revenue	435,915	497,664	(61,749)	(12.4)	100.0	100.0
Cost of sales:						
Industrial Group	261,492	346,894	85,402	24.6	*93.7*	*95.2*
Aerospace & Defense	95,496	73,832	(21,664)	(29.3)	*91.4*	*84.4*
Test & Measurement	39,131	35,848	(3,283)	(9.2)	*74.8*	*78.6*
Electronics Group	134,627	109,680	(24,947)	(22.7)	*85.8*	*82.4*
Total cost of sales	396,119	456,574	60,455	13.2	90.9	91.7
Gross profit:						
Industrial Group	17,590	17,676	(86)	(0.5)	*6.3*	*4.8*
Aerospace & Defense	9,009	13,659	(4,650)	(34.0)	*8.6*	*15.6*
Test & Measurement	13,197	9,755	3,442	35.3	*25.2*	*21.4*
Electronics Group	22,206	23,414	(1,208)	(5.2)	*14.2*	*17.6*
Total gross profit	39,796	41,090	(1,294)	(3.1)	9.1	8.3
Selling, general and administrative	40,517	37,107	(3,410)	(9.2)	9.3	7.5
Research and development	2,821	1,988	(833)	(41.9)	0.6	0.4
Amortization of intangible assets	527	645	118	18.3	0.1	0.1
Nonrecurring (income) expense, net	(3,246)	1,485	4,731	NM	(0.7)	0.3
Operating loss	(823)	(135)	(688)	(509.6)	(0.2)	0.0
Interest expense, net	3,685	3,708	23	0.6	0.8	0.8
Other expense (income), net	31	(387)	(418)	NM	(0.0)	(0.1)

Loss before income taxes	(4,539)	(3,456)	(1,083)	(31.3)	(1.0)	(0.7)
Income taxes	(2,400)	(2,094)	306	14.6	(0.5)	(0.4)
Net loss	$ (2,139)	$ (1,362)	$ (777)	(57.0)%	(0.5)%	(0.3)%

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Backlog. Our backlog increased $7.4 million to $106.9 million at December 31, 2007, on $164.2 million in net orders in 2007 compared to $131.3 million in 2006. We expect to convert approximately 80% of the backlog at December 31, 2007 to revenue during 2008.

Backlog for our Aerospace & Defense segment increased $5.1 million to $99.1 million at December 31, 2007, on $109.6 million in net orders in 2007 compared to $83.5 million in 2006. Backlog for our Test & Measurement segment increased $2.3 million to $7.8 million at December 31, 2007 on $54.6 million in net orders in 2007 compared to $47.7 million in 2006. We expect to convert approximately 79% of the Aerospace & Defense backlog and approximately 100% of the Test & Measurement backlog at December 31, 2007 to revenue during 2008.

Net Revenue. The Industrial Group derives its revenue from manufacturing services and product sales. Net revenue in the Industrial Group decreased $85.5 million to $279.1 million in 2007. Lower sales volume attributable to reduced demand from customers in the heavy truck and trailer markets accounted for decreased revenue of approximately $84.5 million and $9.9 million, respectively. Revenue also declined approximately $12.6 million from the discontinued sale of housings components to a customer in the heavy truck market. The volume declines were partially offset by increased pricing of approximately $8.6 million on certain light truck components and additional revenue of approximately $11.8 million attributable to arbitration payments and the settlement agreement with Dana for certain components supplied during 2007.

The Aerospace & Defense segment derives its revenue from product sales and technical outsourced services. Aerospace & Defense segment net revenue increased $17.0 million to $104.5 million primarily due to increased product sales driven by the ramp-up of a new classified program during 2007. Technical outsourced services comprised $5.8 million of the increase primarily as a result of the launch of several new programs.

The Test & Measurement segment derives its revenue from technical services including calibration and component screening, and product sales. Technical services revenue accounted for approximately 88% and 87% of total Test & Measurement revenue in 2007 and 2006, respectively. Test & Measurement segment net revenue increased $6.7 million primarily due to increased demand for technical services.

Gross Profit. The Industrial Group s gross profit decreased $0.1 million to $17.6 million in 2007. The counteracting factors impacting gross profit in 2007 were the sales volume declines in the heavy truck and trailer markets offset by the pricing increase and the Dana settlement revenues. The significant decrease in sales volume and related loss of fixed overhead absorption combined with increased fringe benefit costs and higher contractual labor rates resulted in a reduction in gross profit of approximately $19.2 million. The volume related decrease in gross profit was offset by approximately $8.6 million for the light truck market pricing increase and approximately $10.5 million for the revenue from arbitration payments and the settlement agreement with Dana.

The Aerospace & Defense segment s gross profit decreased $4.7 million to $9.0 million in 2007. Gross profit as a percentage of revenue for 2007 decreased to 8.6% from 15.6% in 2006. The increase in revenue for the segment in 2007 was comprised of a higher mix of lower-margin services and product sales as compared to the prior year. The unfavorable product mix and related gross margin impact was further affected by the delay in a new government contract award with shipments on the new program expected to begin in the first quarter of 2008. Additionally, contract support costs and delayed cost reduction efforts on a government program contributed to the decline in gross profit in 2007.

The Test & Measurement segment s gross profit increased $3.4 million in 2007 primarily due to increased revenues, which also contributed to an increase in gross profit as a percentage of revenue to 25.2% in 2007 from 21.4% in 2006.

Selling, General and Administrative. Selling, general and administrative expense increased $3.4 million in 2007 and increased as a percentage of net revenue to 9.3% in 2007 from 7.5% in 2006 primarily due to compensation-related expenses, recruiting costs and higher employee benefit costs.

Research and Development. Research and development costs increased $0.8 million in 2007 primarily due to new product development efforts within our Aerospace & Defense segment.

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Nonrecurring (Income) Expense, Net. Nonrecurring items include the gain recognized as part of the Dana settlement agreement offset by the write-off of certain accounts receivable and other assets, legal and professional fees incurred as a result of the Dana bankruptcy filing and other transaction related costs.

Interest Expense, Net. Interest expense in 2007 was consistent with 2006. Our weighted average debt outstanding decreased to $53.1 million during 2007 from $65.1 million during 2006, resulting primarily from multiple working capital management initiatives. The weighted average interest rate increased to 6.7% in 2007 from 5.5% in 2006 primarily as a result of the April 2007 modification of our Revolving Credit Agreement and Senior Notes.

Income Taxes. Our effective income tax rate was 52.9% in 2007 as compared to 60.6% for 2006. The change primarily relates to the mix of foreign earnings and domestic losses. In 2006, income tax expense was reduced $0.4 million as a result of the resolution of various domestic federal and state tax liabilities which proved to be less than original estimates.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

	Years Ended December 31,		Year Over Year Change Favorable (Unfavorable)	Year Over Year Percentage Change Favorable (Unfavorable)	Results as Percentage of Net Revenue for the Years Ended December 31,	
	2006	2005			2006	2005
	(in thousands, except percentage data)					
Net revenue:						
Industrial Group	$ 364,570	$ 359,602	$ 4,968	1.4%	73.2%	68.8%
Aerospace & Defense	87,491	115,863	(28,372)	(24.5)	17.6	22.2
Test & Measurement	45,603	47,301	(1,698)	(3.6)	9.2	9.0
Electronics Group	133,094	163,164	(30,070)	(18.4)	26.8	31.2
Total net revenue	497,664	522,766	(25,102)	(4.8)	100.0	100.0
Cost of sales:						
Industrial Group	346,894	336,686	(10,208)	(3.0)	*95.2*	*93.6*
Aerospace & Defense	73,832	98,367	24,535	24.9	*84.4*	*84.9*
Test & Measurement	35,848	36,375	527	1.4	*78.6*	*76.9*
Electronics Group	109,680	134,742	25,062	18.6	*82.4*	*82.6*
Total cost of sales	456,574	471,428	14,854	3.2	91.7	90.2
Gross profit:						
Industrial Group	17,676	22,916	(5,240)	(22.9)	*4.8*	*6.4*
Aerospace & Defense	13,659	17,496	(3,837)	(21.9)	*15.6*	*15.1*
Test & Measurement	9,755	10,926	(1,171)	(10.7)	*21.4*	*23.1*
Electronics Group	23,414	28,422	(5,008)	(17.6)	*17.6*	*17.4*
Total gross profit	41,090	51,338	(10,248)	(20.0)	8.3	9.8
Selling, general and administrative	37,107	35,669	(1,438)	(4.0)	7.5	6.8
Research and development	1,988	2,833	845	29.8	0.4	0.6
Amortization of intangible assets	645	614	(31)	(5.0)	0.1	0.1
Nonrecurring expense	1,485		(1,485)	NM	0.3	0.0
Operating (loss) income	(135)	12,222	(12,357)	NM	0.0	2.3
Interest expense, net	3,708	5,979	2,271	38.0	0.8	1.1

Other income, net	(387)	(1,325)	(938)	(70.8)	(0.1)	(0.2)
(Loss) income before income taxes	(3,456)	7,568	(11,024)	NM	(0.7)	1.4
Income taxes	(2,094)	2,247	4,341	NM	(0.4)	0.4
Net (loss) income	$ (1,362)	$ 5,321	$ (6,683)	NM%	(0.3)%	1.0%

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Backlog. Excluding the backlog from our Industrial Group, which ceased to be tracked starting January 1, 2006, our backlog decreased $2.4 million to $99.5 million at December 31, 2006, on $131.3 million in net orders in 2006 compared to $146.4 million in 2005.

Backlog for our Aerospace & Defense segment decreased $4.2 million to $94.0 million at December 31, 2006, on $83.5 million in net orders in 2006 compared to $99.9 million in 2005. Backlog for our Test & Measurement segment increased $1.8 million to $5.5 million at December 31, 2006 on $47.7 million in net orders in 2006 compared to $46.5 million in 2005.

Net Revenue. The Industrial Group derives its revenue from manufacturing services and product sales. Net revenue in the Industrial Group for the year increased $5.0 million to $364.6 million primarily due to $12.2 million in additional volume, $7.7 million of material pricing pass-through and $0.5 million of price increases which were offset by the cessation of two business lines.

The Aerospace & Defense segment derives its revenue from product sales and technical outsourced services. Aerospace & Defense segment net revenue decreased $28.4 million to $87.5 million due to a $32.6 million decline in volume as a result of one encryption product completing its life cycle during 2006, while the launch of the next generation product was delayed into 2008, as well as maturing manufacturing service programs and declines in data storage product sales. All such decreases were partially offset by $4.1 million of pricing increases over the prior year, primarily driven by a manufacturing service program.

The Test & Measurement segment derives its revenue from technical services including calibration and component screening, and product sales. Technical services revenue accounted for approximately 87% and 84% of total Test & Measurement revenue in 2006 and 2005, respectively. Test & Measurement segment net revenue decreased $1.7 million due to a $1.5 million sales decline in a military program product, with the remainder due to decreased technical services sales.

Gross Profit. The Industrial Group s gross profit decreased $5.2 million in 2006 primarily due to $2.6 million of production inefficiencies which combined with inflationary increases in salary and fringe benefits, utility costs, supplies expenses and material revaluation impacts on scrap expense of $2.4 million, $1.4 million, $0.3 million and $0.2 million, respectively, which were partially offset by increased volume associated with higher revenue. Gross profit as a percentage of revenue decreased to 4.8% for 2006 from 6.4% in 2005 as a result of the aforementioned production inefficiencies, higher energy costs and salary and fringe benefits along with the impact of declining overhead absorption rates resulting from inventory reduction initiatives.

The Aerospace & Defense segment s gross profit decreased $3.8 million in 2006 primarily due to the decline in volume of one encryption product which completed its life cycle during 2006, while the launch of the next generation product was delayed until 2008. Gross margin for the Aerospace & Defense segment was 15.6% in 2006 as compared to 15.1% in 2005. The increase in gross margin percentage resulted primarily from a more favorable mix of product sales with higher gross margins versus manufacturing services.

The Test & Measurement segment s gross profit decreased $1.2 million in 2006 primarily due to an unfavorable shift in sales mix from product sales and component screening services with higher margins for technical services sales.

Selling, General and Administrative. Selling, general and administrative expense increased $1.4 million in 2006 and increased as a percentage of net revenue to 7.5% in 2006 from 6.8% in 2005. The increase was primarily driven by a $0.8 million increase in stock compensation expense as required under SFAS No. 123R, a $0.6 million increase in administrative costs in the Industrial Group related to a full year of additional infrastructure to support the new contracts in the Industrial Group, and a $0.5 million increase in allowances for bad debts for the Aerospace & Defense segment, all of which were partially offset by a decrease for the Test & Measurement segment primarily resulting from reduced headcount and severance costs in the prior period which did not recur.

Research and Development. Research and development costs decreased $0.8 million in 2006 due to a $1.4 million reduction in two of our data systems product development projects, which was partially offset by new intellectual property investments under a manufacturing service program and initial investments in a new product offering within our Aerospace & Defense segment.

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Amortization of Intangible Assets. Amortization of intangible assets remained consistent with the prior year period.

Nonrecurring Expense. Nonrecurring items include legal and professional fees incurred as a result of the Dana bankruptcy filing and other transaction related costs.

Interest Expense, Net. Interest expense decreased in 2006 due to a decrease in our weighted average debt outstanding. Our weighted average debt outstanding decreased to $65.1 million during 2006 from $115.9 million during 2005, resulting primarily from multiple working capital management initiatives. The weighted average interest rate increased to 5.5% in 2006 from 5.2% in 2005.

Other Income, Net. Other income, net decreased $0.9 million in 2006 due primarily to lower foreign currency remeasurement gains of U.S. Dollar denominated accounts of our foreign subsidiaries.

Income Taxes. Our effective income tax rate was 60.6% in 2006 as compared to 29.7% for 2005. The change primarily relates to the mix of foreign earnings and domestic losses. The change from prior year also reflects the impact of a change in the Mexican statutory tax rate to 29% for 2006 from 30% in 2005. In 2006 and 2005, tax expense was reduced $0.4 million and $0.2 million, respectively as a result of the resolution of various domestic federal and state tax liabilities which proved to be less than original estimates.

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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, 2007. Beginning January 1, 2007, we began to report quarterly results on a 4-4-5 fiscal quarter 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. The consolidated results of operations for any quarter are not necessarily indicative of the results to be expected for any subsequent period.

	2007				2006			
	First	Second	Third	Fourth	First	Second	Third	Fourth
	(in thousands, except per share data)							
Net revenue:								
Industrial Group	$ 79,119	$ 73,472	$ 67,595	$ 58,896	$ 92,499	$ 98,454	$ 93,021	$ 80,596
Aerospace & Defense	19,671	29,380	23,604	31,850	26,011	21,917	21,166	18,397
Test & Measurement	12,649	13,395	13,321	12,963	11,487	11,862	11,768	10,486
Electronics Group	32,320	42,775	36,925	44,813	37,498	33,779	32,934	28,883
Total net revenue	111,439	116,247	104,520	103,709	129,997	132,233	125,955	109,479
Cost of sales:								
Industrial Group	73,799	69,723	62,882	55,088	86,550	93,963	87,871	78,510
Aerospace & Defense	16,516	28,603	21,133	29,244	22,056	18,570	18,559	14,647
Test & Measurement	9,117	10,220	10,033	9,761	8,772	9,266	9,289	8,521
Electronics Group	25,633	38,823	31,166	39,005	30,828	27,836	27,848	23,168
Total cost of sales	99,432	108,546	94,048	94,093	117,378	121,799	115,719	101,678
Gross profit:								
Industrial Group	5,320	3,749	4,713	3,808	5,949	4,491	5,150	2,086
Aerospace & Defense	3,155	777	2,471	2,606	3,955	3,347	2,607	3,750
Test & Measurement	3,532	3,175	3,288	3,202	2,715	2,596	2,479	1,965
Electronics Group	6,687	3,952	5,759	5,808	6,670	5,943	5,086	5,715
Total gross profit	12,007	7,701	10,472	9,616	12,619	10,434	10,236	7,801
Selling, general and administrative	10,596	8,775	10,369	10,777	9,498	9,376	9,600	8,633
Research and development	679	714	608	820	334	371	427	856
Amortization of intangible assets	164	164	129	70	159	158	163	165
Nonrecurring expense (income), net	306	1,248	(4,835)	35	421	256	575	233
Operating income (loss)	262	(3,200)	4,201	(2,086)	2,207	273	(529)	(2,086)
Interest expense, net	719	914	991	1,061	1,159	1,083	820	646
Other (income) expense, net	(20)	61	(26)	16	(250)	(8)	12	(141)
Loss (income) before income taxes	(437)	(4,175)	3,236	(3,163)	1,298	(802)	(1,361)	(2,591)
Income tax (benefit) expense	(192)	(1,874)	599	(933)	441	(358)	(559)	(1,618)
Net (loss) income	$ (245)	$ (2,301)	$ 2,637	$ (2,230)	$ 857	$ (444)	$ (802)	$ (973)
(Loss) earnings per common share:								
Basic	$ (0.01)	$ (0.13)	$ 0.14	$ (0.12)	$ 0.05	$ (0.02)	$ (0.04)	$ (0.05)
Diluted	$ (0.01)	$ (0.13)	$ 0.14	$ (0.12)	$ 0.05	$ (0.02)	$ (0.04)	$ (0.05)

Cash dividends per common share	$ 0.03	$ 0.03	$ 0.03	$ 0.03	$ 0.03	$ 0.03	$ 0.03	$ 0.03
Shares used in computing (loss) earnings per common share:								
Basic	18,107	18,169	18,314	18,332	18,042	18,065	18,094	18,084
Diluted	18,107	18,169	18,548	18,332	18,289	18,065	18,094	18,084

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Liquidity, Capital Resources and Financial Condition

Net cash used in operating activities was $10.5 million in 2007, as compared to net cash provided of $52.8 million in 2006, primarily due to the timing of working capital improvements in 2006, which were not repeated in 2007 and the return to pre-Chapter 11 payment terms under the settlement agreement with Dana. Additionally, net cash used in operating activities is due to the timing of collections and includes increases in inventory to support the ramp-up of new product programs in the Aerospace & Defense segment. In 2007, accounts receivable increased $6.1 million primarily due to the timing of collections from governmental agencies, and accounts payable decreased $16.8 million driven by lower volumes in the Industrial Group. Inventory decreased $6.0 million primarily to adjust for lower sales volumes in the Industrial Group and due to an emphasis on reducing inventory days. Other current assets increased $2.7 million primarily as a result of an increase in deferred contract costs. Accrued liabilities increased $10.8 million primarily as a result of foreign income taxes payable resulting from the Dana settlement agreement and a customer payment received in advance.

Net cash used in investing activities was $9.4 million in 2007 as compared to $10.3 million in 2006. Capital expenditures decreased slightly to $10.2 million in 2007 from $10.3 million in 2006.

Net cash provided by financing activities was $2.1 million in 2007 as compared to cash used of $22.1 million in 2006. In 2006, we made net repayments totaling $20.0 million on our revolving credit facility as a result of cash flow from operations under our various working capital management initiatives. Additionally, we also paid $0.9 million in financing fees in conjunction with modifications of our debt in 2007.

We had total borrowings under our revolving credit facility of $35.0 million at December 31, 2007, and an unrestricted cash balance of $14.6 million. Approximately $2.5 million of the unrestricted cash balance relates to our Mexican subsidiaries. In April 2007, our Revolving Credit Agreement was amended and restated to limit total borrowings at $50.0 million, with $50.0 million of additional borrowings available upon lead bank approval, and to extend the credit agreement through October 2009. We also amended the Senior Notes in April 2007, repaid $25.0 million of principal and modified the June 30, 2014 principal payment to June 30, 2012. The amendments for the Senior Notes and Revolving Credit Agreement also increased our interest rates, revised certain financial covenants and added a security interest in our accounts receivable, inventory and equipment. Other terms of the Revolving Credit Agreement and Senior Notes remain substantially unchanged. Standby letters of credit up to a maximum of $15.0 million may be issued under the Credit Agreement of which $1.9 million were issued at December 31, 2007.

Our principal commitments at December 31, 2007 consisted of repayments of borrowings under the Revolving Credit Agreement and Senior Notes, pension obligations and obligations under operating leases for certain of our real property and equipment. Estimated pension contributions for 2008 are expected to range from $0.1 million to $0.5 million. We also had purchase commitments totaling approximately $38.4 million at December 31, 2007, primarily for inventory and manufacturing equipment. The following table provides the payment dates of our debt and contractual lease obligations at December 31, 2007, excluding current liabilities except for the current portion of long-term debt (amounts in thousands):

	2008	2009	2010	2011	2012	2013 & Thereafter
Revolving credit facility	$ 5,000	$ 30,000	$	$	$	$
Senior notes		4,100		15,000	10,900	
Operating leases	7,323	5,981	3,053	2,700	2,560	7,253
Total	$ 12,323	$ 40,081	$ 3,053	$ 17,700	$ 13,460	$ 7,253

Due to the uncertainty with the respect to the timing of future cash flows associated with the Company s unrecognized tax benefits at December 31, 2007, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority. Therefore, $0.9 million of unrecognized tax benefits have been excluded from the contractual obligations table above. See Note 16 to the consolidated financial statements for a discussion on income taxes.

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At December 31, 2007 we also had approximately $9.5 million of federal net operating loss carryforwards available to offset future federal taxable income, which will expire on December 31, 2026.

We believe that sufficient resources will be available to satisfy our cash requirements for at least the next twelve months. Our assessment of the availability of funds for the next twelve months is based in part on our intent and ability to continue to own the shares of common stock of DAN received through the settlement agreement reached in August 2007. We will continue to monitor the market price and the factors impacting the market price of the DAN common stock. We expect to own our shares of the DAN common stock until the value indicated by the market price approximates the estimated recoverable amount we recognized at the time of the settlement agreement.

Cash requirements for periods beyond the next twelve months depend on our profitability, our ability to manage working capital requirements and our rate of growth. If we make significant acquisitions, if our largest customers experience financial difficulty, or if working capital and capital expenditure requirements exceed expected levels during the next twelve months or in subsequent periods, we may require additional external sources of capital. There can be no assurance that any additional required financing will be available through bank borrowings, debt or equity financings or otherwise, or that if such financing is available, it will be available on terms acceptable to us. If adequate funds are not available on acceptable terms, our business, consolidated results of operations and financial condition could be adversely affected.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements*. The objective of SFAS No. 157 is to increase consistency and comparability in fair value measurements and to expand disclosures about fair value measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. The provisions of SFAS No. 157 are effective for fair value measurements made in fiscal years beginning after November 15, 2007. On February 12, 2008, the FASB issued FASB Staff Position SFAS No. 157-2, *Effective Date of FASB Measurement No. 157.* SFAS No. 157-2 amends SFAS No. 157 to delay the effective date of this Statement for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). For items within its scope, SFAS No. 157-2 defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company will adopt this standard on January 1, 2009 but does not currently believe it will have a material impact on its financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment to FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 permits an entity to choose to measure many financial instruments and certain other items at fair value that are currently not required to be measured at fair value. Under SFAS No. 159, entities that elect the fair value option will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option may be elected on an instrument-by instrument basis, with a few exceptions, as long as it is applied to the instrument in its entirety. The fair value option election is irrevocable, unless a new election date occurs. The statement establishes presentation and disclosure requirements to help financial statement users understand the effect of the entity s election on its earnings. SFAS No. 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. The Company is currently analyzing the potential adoption and impact, if any, of SFAS No. 159 on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 revised 2007 (SFAS No. 141R), *Business Combinations*. SFAS 141R establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable financial statement users to evaluate the nature and financial effects of the business combination. SFAS No. 141R applies to business combinations for which the acquisition date is on or after December 15, 2008. Early adoption is prohibited. SFAS No. 141R will be applied to acquisitions in the future.

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

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to financial market risks, including changes in interest rates and foreign currency exchange rates. All additional borrowings under our credit agreement bear interest at a variable rate based on the prime rate, the London Interbank Offered Rate (LIBOR), or certain alternative short-term rates, plus a margin (1.75% at December 31, 2007) based upon our leverage ratio. A change in interest rates of 100 basis points would result in additional interest expense of less than $0.4 million on an annualized basis, based upon our debt outstanding at December 31, 2007. A change in fixed interest rates of 100 basis points would change the fair value of our Senior Notes by $1.0 million. Fluctuations in foreign currency exchange rates have historically impacted our earnings only to the extent of remeasurement gains related to U.S. Dollar denominated accounts of our foreign subsidiary, because the vast majority of our transactions are denominated in U.S. Dollars. A one percent change in foreign currency exchange rates would result in remeasurement gain or loss of approximately $0.4 million on an annualized basis, based upon the U.S. Dollar denominated accounts of our foreign subsidiary at December 31, 2007. Inflation has not been a significant factor in our operations in any of the periods presented; however, there can be no assurances that the costs of steel will not adversely affect our working capital requirements and our associated interest costs, which could also increase the sensitivity of our results to changes in interest rates.

With respect to our ownership of common stock in DAN, we are also subject to equity price risk. On January 31, 2008, the Company received approximately 3.1 million shares of DAN common stock in its initial distribution from the bankrupt estate. Subsequent distributions are anticipated following the resolution of disputed matters within the estate. The Company anticipates receiving approximately 0.4 million additional shares following the resolution of these matters. Based on these assumptions, a permanent change of $1.00 per share in the value of DAN stock would change the fair value of our holdings by approximately $3.5 million.

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Item 8. Financial Statements and Supplementary Data

SYPRIS SOLUTIONS, INC.

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MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Sypris Solutions, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Our internal control system was designed to provide reasonable assurance to Sypris management and its Board of Directors regarding the preparation and fair presentation of published consolidated financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can only provide reasonable assurance with respect to the accuracy of consolidated financial statement preparation and presentation.

Under the supervision and with participation of our management, including the Chief Executive Officer and Chief Financial Officer, we assessed the effectiveness of Sypris Solutions, Inc. s internal control over financial reporting as of December 31, 2007. In making our assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control Integrated Framework. Based on our assessment, we concluded that as of December 31, 2007, Sypris internal control over financial reporting is effective based on these criteria.

Ernst & Young LLP, our independent auditors and a registered public accounting firm, has audited and reported on the consolidated financial statements of Sypris Solutions, Inc. and on the effectiveness of our internal controls over financial reporting. The reports of Ernst & Young LLP are contained in this Annual Report.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Sypris Solutions, Inc.

We have audited Sypris Solutions, Inc. s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Sypris Solutions, Inc. s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Sypris Solutions, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Sypris Solutions, Inc. as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2007, and our report dated March 6, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Louisville, Kentucky

March 6, 2008

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Sypris Solutions, Inc.

We have audited the accompanying consolidated balance sheets of Sypris Solutions, Inc. (the Company) as of December 31, 2007 and 2006, and the related consolidated statements of operations, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statements schedule listed in the Index at Item 15(a)2. These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sypris Solutions, Inc. at December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2006, the Company changed its method of accounting for stock-based compensation to conform to Statement of Financial Accounting Standards No. 123(R), *Share-Based Payments* . As further discussed in Note 1 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standard No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)* as of December 31, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Sypris Solutions, Inc. s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 6, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Louisville, Kentucky

March 6, 2008

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SYPRIS SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except for per share data)

	Years ended December 31,		
	2007	**2006**	**2005**
Net revenue:			
Outsourced services	$ 354,215	$ 429,977	$ 446,232
Products	81,700	67,687	76,534
Total net revenue	435,915	497,664	522,766
Cost of sales:			
Outsourced services	327,089	407,483	418,148
Products	69,030	49,091	53,280
Total cost of sales	396,119	456,574	471,428
Gross profit	39,796	41,090	51,338
Selling, general and administrative	40,517	37,107	35,669
Research and development	2,821	1,988	2,833
Amortization of intangible assets	527	645	614
Nonrecurring (income) expense, net	(3,246)	1,485	
Operating (loss) income	(823)	(135)	12,222
Interest expense, net	3,685	3,708	5,979
Other (income) expense, net	31	(387)	(1,325)
(Loss) income before income taxes	(4,539)	(3,456)	7,568
Income tax (benefit) expense	(2,400)	(2,094)	2,247
Net (loss) income	$ (2,139)	$ (1,362)	$ 5,321
(Loss) earnings per common share:			
Basic	$ (0.12)	$ (0.08)	$ 0.30
Diluted	$ (0.12)	$ (0.08)	$ 0.29
Cash dividends per common share	$ 0.12	$ 0.12	$ 0.12
Shares used in computing (loss) earnings per common share:			
Basic	18,231	18,079	18,016
Diluted	18,231	18,079	18,323

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

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SYPRIS SOLUTIONS, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except for share data)

	December 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,622	$ 32,400
Restricted cash	883	1,002
Accounts receivable, net	59,067	59,876
Inventory, net	71,789	74,146
Other current assets	107,132	34,014
Total current assets	253,493	201,438
Property, plant and equipment, net	137,104	155,341
Goodwill	14,277	14,277
Other assets	17,186	7,977
Total assets	$ 422,060	$ 379,033
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 54,119	$ 76,291
Accrued liabilities	41,933	19,430
Current portion of long-term debt	5,000	5,000
Total current liabilities	101,052	100,721
Long-term debt	60,000	55,000
Other liabilities	53,529	13,426
Total liabilities	214,581	169,147
Commitments and contingencies		
Stockholders equity:		
Preferred stock, par value $0.01 per share, 975,150 shares authorized; no shares issued		
Series A preferred stock, par value $0.01 per share, 24,850 shares authorized; no shares issued		
Common stock, non-voting, par value $0.01 per share, 10,000,000 shares authorized; no shares issued		
Common stock, par value $0.01 per share, 30,000,000 shares authorized; 19,205,247 shares issued and 19,078,440 outstanding in 2007 and 18,342,243 shares issued and 18,338,484 outstanding in 2006	192	183
Additional paid-in capital	146,025	143,537
Retained earnings	65,402	69,816
Accumulated other comprehensive loss	(3,943)	(3,634)
Treasury stock, 126,807 and 3,759 shares in 2007 and 2006, respectively	(197)	(16)
Total stockholders equity	207,479	209,886
Total liabilities and stockholders equity	$ 422,060	$ 379,033

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

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SYPRIS SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Years ended December 31,		
	2007	**2006**	**2005**
Cash flows from operating activities:			
Net (loss) income	$ (2,139)	$ (1,362)	$ 5,321
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:			
Depreciation and amortization	29,386	28,782	25,909
Deferred income taxes	(15,373)	(5,079)	(1,091)
Provision for excess and obsolete inventory	1,322	836	739
Provision for doubtful accounts	(132)	437	607
Noncash compensation	1,363	1,034	219
Other noncash (gains) charges, net	(15,758)	142	123
Contributions to pension plans	(392)	(1,122)	(79)
Changes in operating assets and liabilities, net of acquisitions:			
Accounts receivable	(6,059)	35,112	8,595
Inventory	5,964	5,123	11,555
Other current assets	(2,684)	(7,113)	3,363
Accounts payable	(16,769)	35	15,119
Accrued and other liabilities	10,767	(4,019)	2,208
Net cash (used in) provided by operating activities	(10,504)	52,806	72,588
Cash flows from investing activities:			
Capital expenditures	(10,155)	(10,326)	(36,264)
Proceeds from sale of assets	224	92	649
Changes in nonoperating assets and liabilities	542	(87)	(28)
Net cash used in investing activities	(9,389)	(10,321)	(35,643)
Cash flows from financing activities:			
Net increase (decrease) in debt under revolving credit agreements	30,000	(20,000)	(37,000)
Payments on Senior Notes	(25,000)		
Debt modification costs	(885)	(248)	(597)
Cash dividends paid	(2,264)	(2,193)	(2,164)
Proceeds from issuance of common stock, net	264	296	816
Net cash provided by (used in) financing activities	2,115	(22,145)	(38,945)
Net (decrease) increase in cash and cash equivalents	(17,778)	20,340	(2,000)
Cash and cash equivalents at beginning of year	32,400	12,060	14,060
Cash and cash equivalents at end of year	$ 14,622	$ 32,400	$ 12,060

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

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SYPRIS SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands, except for share data)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock
January 1, 2005 balance	17,920,500	$ 179	$ 140,898	$ 70,227	$ (2,365)	$
Net income				5,321		
Adjustment in minimum pension liability, net of tax of $132					(208)	
Foreign currency translation gain					639	
Comprehensive income				5,321	431	
Cash dividends, $0.12 per common share				(2,173)		
Restricted common stock grant	127,500	2	(2)			
Noncash compensation			219			
Issuance of shares under Employee Stock Purchase Plan	36,177		350			
Exercise of stock options	81,481	1	465			
Stock option tax benefit			181			
December 31, 2005 balance	18,165,658	182	142,111	73,375	(1,934)	
Net loss				(1,362)		
Adjustment in minimum pension liability, net of tax of $578					823	
Foreign currency translation loss					(549)	
Comprehensive (loss) income				(1,362)	274	
Adoption of SFAS No. 158, net of $1,386 of tax					(1,974)	
Cash dividends, $0.12 per common share				(2,197)		
Restricted common stock grant	112,000	1				
Noncash compensation			1,034			
Exercise of stock options	64,585		311			
Treasury stock	(3,759)					(16)
Stock option tax benefit			81			
December 31, 2006 balance	18,338,484	183	143,537	69,816	(3,634)	(16)
Net loss				(2,139)		
Employee benefit related, net of tax of $241					(128)	
Foreign currency translation loss					(181)	
Comprehensive loss				(2,139)	(309)	
Cash dividends, $0.12 per common share				(2,287)		
Restricted common stock grant	613,290	6	(6)			
Noncash compensation	18,097		1,363	12		

Exercise of stock options	71,643		1		445					
Treasury stock	(123,048)									(181)
Stock option exchange	159,974		2		638					
Stock option tax benefit					48					
December 31, 2007 balance	19,078,440	$	192	$	146,025	$ 65,402	$	(3,943)	$	(197)

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

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SYPRIS SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Organization and Significant Accounting Policies

Consolidation Policy

The accompanying consolidated financial statements include the accounts of Sypris Solutions, Inc. and its wholly-owned subsidiaries (collectively, Sypris or the Company) and have been prepared by the Company in accordance with the rules and regulations of the Securities and Exchange Commission. The Company s operations are domiciled in the United States (U.S.) and Mexico and serve a wide variety of domestic and international customers. All significant intercompany accounts and transactions have been eliminated.

Nature of Business

Sypris is a diversified provider of outsourced services and specialty products. The Company performs a wide range of manufacturing, engineering, design, testing, and other technical services, typically under multi-year, sole-source contracts with corporations and government agencies in the markets for truck components & assemblies, aerospace & defense electronics, and test & measurement services. The Company provides such services through its Industrial and Electronics Groups (Note 18).

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Specifically, due to the size and nature of the Company s aerospace & defense related programs, the estimation of total contract related revenues and cost at completion is subject to a wide range of variables. As contracts may require performance over several accounting periods, formal detailed cost-to-complete estimates are performed and updated monthly. Management s estimates of costs-to-complete change due to internal and external factors, such as labor rate and efficiency variances, revised estimates of warranty costs, estimated future material prices and customer specification and testing requirement changes. Actual results could differ from those estimates.

Cash Equivalents and Restricted Cash

Cash equivalents include all highly liquid investments with a maturity of three months or less when purchased, while restricted cash consists of amounts funded to the Company by a Landlord under a new lease agreement signed in 2006. Under the terms of the lease, the funds are required to be expended on leasehold improvements.

Inventory

Inventory is stated at the lower of cost or estimated net realizable value. Costs for raw materials, work in process and finished goods, excluding contract inventory included in the Electronics Group, is determined under the first-in, first-out method. Indirect inventories, which include perishable tooling, repair parts and other materials consumed in the manufacturing process but not incorporated into finished products are classified as raw materials.

Costs on long-term contracts and programs in progress represent recoverable costs incurred for production or contract-specific materials and equipment, allocable operating overhead, advances to suppliers and where appropriate, pre-contract engineering and design expenses. Pursuant to contract provisions, agencies of the U.S. Government and certain other customers have title to, or a security interest in, inventories related to such contracts as a result of advances, performance based payments and progress payments. Such advances and payments are reflected as an offset against the related inventory balances. General administrative expenses related to commercial products and services provided essentially under commercial terms and conditions are expensed as incurred.

SYPRIS SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

The Company s reserve for excess and obsolete inventory is primarily based upon forecasted demand for its product sales, and any change to the reserve arising from forecast revisions is reflected in cost of sales in the period the revision is made.

Property, Plant and Equipment

Property, plant and equipment is stated at cost. Depreciation of property, plant and equipment is generally computed using the straight-line method over their estimated economic lives. For land improvements, buildings and building improvements, the estimated economic life is generally 40 years. Estimated economic lives range from three to fifteen years for machinery, equipment, furniture and fixtures. Leasehold improvements are amortized over the shorter of their economic life or the respective lease term using the straight-line method. Expenditures for maintenance, repairs and renewals of minor items are expensed as incurred. Major rebuilds and improvements are capitalized.

Interest cost is capitalized for qualifying assets during the period in which the asset is being installed and prepared for its intended use. Capitalized interest cost is amortized on the same basis as the related depreciation.

Long-lived Assets

When indicators of impairment exist, the Company evaluates long-lived assets for impairment and assesses their recoverability based upon anticipated undiscounted future cash flows. If facts and circumstances indicate that the carrying value of an asset or groups of assets, as applicable, is impaired, the long-lived asset or groups of long-lived assets are written down to their estimated fair value.

Goodwill

Goodwill is tested at least annually for impairment by calculating the estimated fair value of each business with which goodwill is associated. The estimated fair value is determined based on a discounted cash flow basis, which is compared to the carrying value of each applicable business. The Company tested goodwill of $14,277,000 for impairment as of December 31, 2007 and 2006, determining that no impairment loss was necessary. As of December 31, 2007 and 2006, the carrying value of goodwill for the Industrial Group, Aerospace & Defense and the Test & Measurement segments was $440,000, $6,900,000 and $6,937,000, respectively.

Deferred Revenue

Deferred revenue for the Electronics Group is recorded when payments are received in advance of achieving project milestones and is amortized into revenue based on the ratio of costs incurred to our estimate of total costs at completion. Deferred revenue for the Industrial Group is generally associated with the Dana settlement (Note 2) and will be amortized into income on a units-of-production basis over the term of the new supply agreement.

Income Taxes

In the ordinary course of business there is inherent uncertainty in quantifying our income tax positions. The Company assesses our income tax positions and records tax benefits for all years subject to examination based upon management s evaluation of the facts, circumstances, and information available at the reporting dates. For those tax positions where it is more-likely-than-not that a tax benefit will be sustained, we have recorded the largest amount of tax benefit with a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not more-likely-than-not that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements. Where applicable, associated interest has also been recognized.

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48) on

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SYPRIS SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

January 1, 2007. The impact of the Company s tax positions reassessment in accordance with the requirements of FIN 48 was not significant. We recognize interest accrued related to unrecognized tax benefits in income tax expense. Penalties, if incurred, would be recognized as a component of income tax expense.

Net Revenue and Cost of Sales

Net revenue of products and services provided essentially 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 under service-type contracts is recorded as costs are incurred. Applicable estimated profits are included in earnings in the proportion that incurred costs bear to total estimated costs.

Net revenue under long-term, fixed-price contracts with aerospace & defense companies and agencies of the U.S. Government is recognized using the percentage of completion method, primarily using units-of-delivery as the basis to measure progress toward completing the contract and recognizing revenue. Estimated contract profits are taken into earnings in proportion to recorded sales. Sales under certain long-term fixed-price contracts that specifically provide for milestones are recorded as revenue upon achievement of performance milestones, limited to revenue recognized using the cost-to-cost method of accounting where sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. Amounts representing contract change orders or claims are included in revenue when such costs are reliably estimated and realization is probable. When adjustments in contract value or estimated costs are determined, any changes from prior estimates are reflected in earnings in the current period. Anticipated losses on contracts are charged to earnings when determined to be probable. Gross profit for the years ended December 31, 2007, 2006 and 2005 included charges of $3,674,000, $1,025,000 and $3,878,000, respectively, for costs in excess of expected future contract value.

Revenue recognized under the percentage of completion method of accounting totaled approximately $89,777,000, $72,815,000 and $94,419,000 for the years ended December 31, 2007, 2006 and 2005, respectively. In 2007, 2006 and 2005, approximately 90%, 80% and 91%, respectively, of such amount was accounted for based on units of delivery and approximately 10%, 20% and 9%, respectively, was accounted for based on milestones or cost-to-cost.

Product Warranty Costs

The provision for estimated warranty costs is recorded at the time of sale and periodically adjusted to reflect actual experience. The Company s warranty liability, which is included in accrued liabilities in the accompanying balance sheets, as of December 31, 2007 and 2006 was $523,000 and $235,000, respectively. The Company s warranty expense was immaterial in each of the periods presented.

Concentrations of Credit Risk

Financial instruments which potentially expose the Company to concentrations of credit risk consist of accounts receivable. The Company s customer base consists of a number of customers in diverse industries across geographic areas, primarily in North America and Mexico, various departments or agencies of the U.S. Government, and aerospace & defense companies under contract with the U.S. Government. The Company performs periodic credit evaluations of its customers financial condition and does not require collateral on its commercial accounts receivable. Credit losses are provided for in the consolidated financial statements and consistently have been within management s expectations. Approximately 52% and 67% of accounts receivable outstanding at December 31, 2007 and 2006, respectively are due from the Company s four largest customers. More specifically, Dana Corporation (Dana) and ArvinMeritor, Inc. (Arvin Meritor) comprise 21% and 16%, respectively of December 31, 2007 outstanding accounts receivables. Similar amounts at December 31, 2006 were 29% and 30%, respectively.

The Industrial Group s largest customers for the year ended December 31, 2007 were Dana and ArvinMeritor, which represented approximately 34% and 15%, respectively, of the Company s total net revenue.

SYPRIS SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

Dana and ArvinMeritor were the Company s largest customers for the year ended December 31, 2006 which represented approximately 41% and 19%, respectively, of the Company s total net revenue. Dana and ArvinMeritor were the Company s largest customers for the year ended December 31, 2005, which represented approximately 39% and 15%, respectively, of the Company s total net revenue. The Company recognized revenue from contracts with the U.S. Government and its agencies approximating 12%, 8% and 9% of net revenue for the years ended December 31, 2007, 2006 and 2005, respectively. No other single customer accounted for more than 10% of the Company s total net revenue for the years ended December 31, 2007, 2006 or 2005.

Foreign Currency Translation

The functional currency for the Company s Mexican subsidiary is the Mexican peso. Assets and liabilities are translated at the period end exchange rate, and income and expense items are translated at the period end weighted average exchange rate. The resulting translation adjustments are recorded in comprehensive income (loss) as a separate component of stockholders equity. Remeasurement gains or losses for U.S. dollar denominated accounts of the Company s Mexican subsidiary are included in other income, net.

Collective Bargaining Agreements

Approximately 883 or 41% of the Company s employees, all of which are in the Industrial Group, are covered by collective bargaining agreements. Excluding certain Mexico employees covered under an annually ratified agreement, collective bargaining agreements covering 240 employees, or 11% of the Company s workforce, are subject to renewal in the next 12 months. Certain Mexico employees are covered by an annually ratified collective bargaining agreement and represent approximately 151 employees, or 7% of the Company s workforce.

Adoption of Recently Issued Accounting Standards

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. Specifically, FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of FIN 48 on January 1, 2007. The impact of the Company s tax positions reassessment in accordance with the requirements of FIN 48 was not significant.

On September 29, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)*. On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS No. 158, which required the Company to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plan in the December 31, 2006 statement of financial position, with a corresponding adjustment to accumulated other comprehensive income, net of tax. The adjustment to accumulated other comprehensive income at adoption represented the net unrecognized actuarial losses and unrecognized prior service costs, all of which were previously netted against the plan s funded status in the Company s statement of financial position pursuant to the provisions of SFAS No. 87. These amounts, noted below, will be subsequently recognized as net periodic pension cost pursuant to the Company s historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic pension cost in the same periods will be recognized as a component of other comprehensive income. Those amounts will be subsequently recognized as a component of net periodic pension cost pursuant to the Company s historical accounting policy for amortizing such amounts.

The incremental effects of adopting the provisions of SFAS No. 158 on the Company s statement of financial position at December 31, 2006 are presented in the following table. The adoption of SFAS No. 158 had no

SYPRIS SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

effect on the Company s consolidated statement of operations for the year ended December 31, 2006, or for any prior period presented, and it will not effect the Company s operating results in future periods. Had the Company not been required to adopt SFAS No. 158 at December 31, 2006, it would have recognized an additional minimum liability pursuant to the provisions of SFAS No. 87. The effect of recognizing the additional minimum liability is included in the table below in the column labeled Prior to Adopting of SFAS No. 158.

	December 31, 2006		
	Prior to Adopting SFAS No. 158	Effect of Adopting SFAS No. 158 (in thousands)	Reported Balance
Other assets (pension)	$ 5,071	$ (3,212)	$ 1,859
Other liabilities (pension)	(3,989)	(148)	(4,137)
Other liabilities (deferred taxes)	1,446	1,307	2,753
Accumulated other comprehensive income (loss)	(3,735)	(3,360)	(7,095)

In December 2004, the FASB issued FASB Statement No. 123 (revised 2004), *Share-Based Payment*. SFAS No. 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), and amends FASB Statement No. 95, *Statement of Cash Flows*. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized as expense based on their fair values. Pro forma disclosure is no longer an alternative. The Company adopted SFAS No. 123(R) on January 1, 2006, using the modified prospective method and, accordingly, the financial statements for prior periods do not reflect any restated amounts. In accordance with SFAS No. 123(R), the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

As a result, selling general and administrative expense, net loss, basic loss per common share and diluted loss per common share for the year ended December 31, 2006 includes $1,034,000, $646,000, $0.04 and $0.04, respectively related to non-cash compensation expense. Non-cash compensation expense included in selling general and administrative expense, net loss, basic earnings per common share and diluted earnings per common share for 2005 were $219,000, $134,000, $0.01 and $0.01, respectively. No stock-based compensation was capitalized into inventory, or property plant and equipment during 2007, 2006 or 2005. In conjunction with the adoption of SFAS No. 123(R), the Company selected the straight-line amortization method for graded vesting options granted subsequent to January 1, 2006. Prior to that date, the Company used an accelerated method previously required for graded vesting awards.

As permitted by SFAS No. 123, the Company historically accounted for stock option grants in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. Had the Company adopted SFAS No. 123(R) in prior periods, the impact would have approximated the impact of SFAS No. 123 pro forma disclosure below, excluding the impact of the underwater option accelerations in 2005. The Company s pro forma information is as follows (in thousands except per share data):

	Year ended December 31, 2005
Net income	$ 5,321
Pro forma stock-based compensation expense, net of tax	2,597
Pro forma net income	$ 2,724

Pro forma earnings per common share:		
Basic	$	0.15
Diluted	$	0.15

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SYPRIS SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

On March 1, 2005, April 25, 2005 and December 28, 2005, the Board of Directors approved resolutions to accelerate the vesting for underwater options as of March 11, 2005, April 25, 2005 and December 30, 2005, respectively in order to reduce future compensation expense related to outstanding options. Substantially all other options terms remained unchanged. After amendment of the underlying option agreements, compensation expense to be recognized in the statement of operations, subsequent to the adoption of SFAS No. 123(R) was reduced by approximately $1,573,000, net of tax.

Reclassifications

Certain amounts in the Company s 2006 consolidated financial statements have been reclassified to conform to the 2007 presentation.

(2) Dana Bankruptcy

On March 3, 2006 (Filing Date), the Company s largest customer, Dana, and 40 of its U.S. subsidiaries, filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York. Dana s European, South American, Asia-Pacific, Canadian and Mexican subsidiaries were excluded from the Chapter 11 filing.

On December 6, 2006, an independent arbitrator initially held that Dana had breached certain of its agreements with Sypris by failing to transfer certain volumes of business and by failing to pay the appropriate prices for the volumes that were transferred. As a result, the arbitrator awarded payments to Sypris totaling $1,812,212 plus $146,258 per month on an ongoing basis. On January 29, 2007, this award became final; and accordingly, net revenue in the consolidated statements of operations for the year ended December 31, 2007 includes $2,875,000 pertaining to the arbitration award. On July 24, 2007, the Company announced that its wholly-owned subsidiary, Sypris Technologies, Inc., entered into a comprehensive settlement agreement with Dana to resolve all outstanding disputes between the parties, terminate any further arbitration payments and enter into a new long-term supply contract running through 2014. This settlement was approved by the bankruptcy court on August 7, 2007.

Pursuant to the settlement agreement, Dana and the Company have (i) entered into a new, long-term master supply agreement in lieu of the three prior supply contracts, (ii) exchanged production of certain non-core components, (iii) rebalanced production among Company plants to reduce costs for both parties, and (iv) ceased all litigation with regard to prior contract disputes, including the release of Dana from certain committed but undelivered production volumes and termination of the arbitration payments. In addition, Dana provided the Company with an allowed general unsecured non-priority claim in the amount of $89,900,000, which was recorded by the Company at its estimated fair value of $76,483,000 as of the August 7, 2007 settlement date. At December 31, 2007, this amount is included in other current assets given the Company s intention, as of that date, to dispose of the investment during the ensuing year.

At December 31, 2007, the Company had deferred $55,772,000 associated with the settlement, of which $12,576,000 is carried in accrued liabilities and $43,196,000 is carried in other liabilities in the consolidated balance sheets. The deferred revenue will be recognized over the term of the new master supply agreement. Approximately $8,911,000 related to the settlement agreement was recognized into revenue, of which $7,634,000 was reflected in gross profit during the year ended December 31, 2007. Approximately $11,798,000 million of the settlement recognized as a non-recurring gain was offset by settlement related charges and professional fees. See Note 20, Subsequent Events, for additional information.

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SYPRIS SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

(3) Accounts Receivable

Accounts receivable consists of the following:

	December 31, 2007	December 31, 2006
	(in thousands)	
Commercial	$ 48,494	$ 60,529
U.S. Government	11,168	849
	59,662	61,378
Allowance for doubtful accounts	(595)	(1,502)
	$ 59,067	$ 59,876

Accounts receivable from the U.S. Government includes amounts due under long-term contracts, all of which are billed at December 31, 2007 and 2006, of $9,680,000 and $746,000 respectively.

(4) Inventory

Inventory consists of the following:

	December 31, 2007	December 31, 2006
	(in thousands)	
Raw materials, including perishable tooling of $1,129 and $1,276 in 2007 and 2006, respectively	$ 21,140	$ 28,885
Work in process	12,815	12,576
Finished goods	7,439	10,129
Costs relating to long-term contracts and programs, net of amounts attributed to revenue recognized to date	39,936	40,451
Progress payments related to long-term contracts and programs	(2,565)	