Recon Technology, Ltd
Form 10-K
September 28, 2009
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U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended June 30, 2009

¨ 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 001-34409

RECON TECHNOLOGY, LTD

(Exact name of registrant as specified in its charter)

Cayman Islands	**Not Applicable**

(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

Room 1902, Building C, King Long International Mansion

No.9 Fulin Road

Beijing, 100107

People s Republic of China

(Address of principal executive offices and zip code)

025-52313015

(Registrant s telephone number, including area code)

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
Ordinary Shares, $0.0185 par value per share	**NASDAQ Capital Market**

Securities registered under Section 12(g) of the Exchange Act:

None.

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

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

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

Indicate by check mark if there is disclosure of delinquent filers in response to Item 405 of Regulation S-K contained in this form, and no disclosure will be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.45 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨ N/A x The registrant is a smaller reporting company.

The aggregate market value of the ordinary shares, $0.0185 par value per share (Shares), of the registrant held by non-affiliates on December 31, 2008 was $0, as there were no Shares held by non-affiliates on such date, and the registrant s Shares were not then publicly traded.

The Company is authorized to issue 25,000,000 Shares. As of the date of this report, the Company has issued and outstanding 3,951,811 Shares.

DOCUMENTS INCORPORATED BY REFERENCE

This Form 10-K incorporates the registration statement filed with the Commission on August 12, 2008, as amended (file no. 333-152964) (the Registration Statement) and prospectus filed pursuant to Rule 424(b)(3) of the Securities Act of 1933 (the Securities Act) on July 24, 2009 (the IPO Prospectus). The Registration Statement and IPO Prospectus are incorporated by reference into Parts I, II and III of this Form 10-K.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

We have made statements in this annual report that constitute forward-looking statements. Forward-looking statements involve risks and uncertainties, such as statements about our plans, objectives, expectations, assumptions or future events. In some cases, you can identify forward-looking statements by terminology such as anticipate, estimate, plan, project, continuing, ongoing, expect, we believe, we should, could and similar expressions. These statements involve estimates, assumptions, known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from any future results, performances or achievements expressed or implied by the forward-looking statements.

Examples of forward-looking statements include:

- projections of revenue, earnings, capital structure and other financial items;
- statements of our plans and objectives;
- statements regarding the capabilities and capacities of our business operations;
- statements of expected future economic performance; and
- assumptions underlying statements regarding us or our business.

The ultimate correctness of these forward-looking statements depends upon a number of known and unknown risks and events. Many factors could cause our actual results to differ materially from those expressed or implied in our forward-looking statements. Consequently, you should not place undue reliance on these forward-looking statements.

The forward-looking statements speak only as of the date on which they are made, and, except as required by law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to update this forward-looking information. Nonetheless, the Company reserves the right to make such updates from time to time by press release, periodic report or other method of public disclosure without the need for specific reference to this Report. No such update shall be deemed to indicate that other statements not addressed by such update remain correct or create an obligation to provide any other updates.

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PART I

Item 1. Business.

The section of the Registration Statements and IPO Prospectus entitled Our Business is incorporated herein by reference.

Item 1A. Risk Factors.

The Company is not required to provide the information required by this Item because the Company is a smaller reporting company.

Item 1B. Unresolved Staff Comments.

The Company is not required to provide the information required by this Item because the Company is a smaller reporting company.

Item 2. Properties.

The section of the Registration Statements and IPO Prospectus entitled Description of Property is incorporated herein by reference.

Item 3. Legal Proceedings.

From time to time, we may become involved in various lawsuits and legal proceedings, which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. We are currently not aware of any such legal proceedings or claims that we believe will have a material adverse affect on our business, financial condition or operating results.

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

The Company did not submit any matters to a vote of security holders during the fourth quarter of 2008.

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PART II

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

(a) None.

(b) Not applicable, as the Company completed its initial public offering on July 29, 2009, after the end of its fiscal year. Accordingly, the Company had not received or applied any proceeds from the offering as of the end of the fiscal year.

(c) None.

Item 6. Selected Financial Data.

The Company is not required to provide the information required by this Item because the Company is a smaller reporting company.

Item 7. Management s Discussion and Analysis or Plan of Operation.

The following discussion and analysis of our Company s financial condition and results of operations should be read in conjunction with our audited consolidated financial statements and the related notes included elsewhere in the Annual Report. This discussion contains forward-looking statements that involve risks and uncertainties. Actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of various factors.

Overview

Organization. We are a company focused on production and service for oil field exploitation industry companies in the People s Republic of China. We provide equipment, tools and other hardware related to oil field production and management and develop and sell our own specialized industrial automation control and information solutions. However, we do not engage in the production of petroleum or petroleum products. We primarily derive our revenue from:

- Design, manufacture and installation of oil field servomechanism systems engineering;
- Oil field underground operation technology and products:
  - Oil producing well water seeking, sand proof, fracturing technology;
  - Down flow well acidize injection, plug-releasing, profile control technology;
  - Gas well perforating and sand proof technology;
  - Multi-effect underground packer devices and

Gas well throttle controller.

Oil field ground operation technology and products:

Heating furnace automation control technology in oil field fathering and transportation system;

Oil field high effect heating furnace;

Oil field multiphase separator;

Oil field heat-exchange equipment and;

Supply Italian UNIGAS combustor.

In the year ended June 30, 2009, approximately 95.53% of our revenues came from hardware sales, 1.98% came from service, and 2.49% came from software sales. Our management believes digitization management of oil and gas wells and stimulation measures will be widely promoted in Chinese oil fields, so we have focused increased attention on these areas. During 2009, our business has benefitted from sales of high-tech products and software systems. Our software sales have increased by the greatest percentage of our areas of business. Our management also believes the development and sales of software products can facilitate the development of our hardware and service business in the future. As a result, our management seeks to strengthen its competitive position in the oil field service industry by developing software products.

The Domestic Companies and our solutions and new technology enable our customers to reduce their expenditures and improve their integrated benefit by changing from manual to mechanized production methods. Our major clients, Sinopec and CNPC, are large oil and refinery firms formed following the Chinese government s decision to decentralize the oil and gas industry within China. Both companies are ranked in the Fortune 500. We aim to continue extending our market share in the short-term and to be a leading non-government-owned service provider to the oil field exploitation industry in the long-term. Our mission is to increase the automation and safety levels of industrial petroleum production in China, and improve the under-developed working process and management mode by using high-technology.

We operate our business in China through the Domestic Companies, which are PRC limited liability companies controlled by the same three PRC residents, Mr. Yin Shenping, Mr. Li Hongqi and Mr. Chen Guangqiang. Mr. Yin, Mr. Li and Mr. Chen are also significant shareholders in and directors of our Company, and they serve, respectively, as our Chief Executive Officer, Chief Marketing Officer and Chief Technology Officer.

Chinese laws and regulations currently do not prohibit or restrict foreign ownership in petroleum businesses. However, Chinese laws and regulations do prevent direct foreign investment in certain industries. To protect our shareholders from possible future foreign ownership restrictions, Mr. Yin, Mr. Li and Mr. Chen reorganized our Company, entered into agreements with Recon-JN and caused Recon-JN and each of the Domestic Companies to enter into a series of agreements that give our Company (by virtue of its sole ownership of Recon-HK and Recon-HK s sole ownership of Recon-JN) effective control over each of the Domestic Companies.

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We have Exclusive Technical Consulting Service Agreements and Operating Agreements with each of the Domestic Companies and Equity Interest Pledge Agreements and Exclusive Equity Interest Purchase Agreements with their shareholders. Through these contractual arrangements, we have the ability to substantially influence each of the Domestic Companies daily operations and financial affairs, appoint their senior executives and approve all matters requiring shareholder approval. As a result of these contractual arrangements, which enable us to control the Domestic Companies, we are considered the primary beneficiary of each Domestic Company. In addition, we and the Domestic Companies are under common control, by virtue of the ownership of more than 60% of our company and each of the Domestic Companies by three shareholders (Mr. Yin Shenping, Mr. Li Hongqi and Mr. Chen Guangqiang).

Based on these agreements, the Domestic Companies are our variable interest entities (VIEs) and we consolidate them as required by Financial Accounting Standards Board (FASB) Interpretation No. 46R (FIN 46R), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51, because we are the primary beneficiary of the VIEs. We do not have any collateral for the obligations of the VIEs.

Factors Affecting Our Business

Industry Background. As a whole, the Chinese petroleum industry faces four primary challenges: (a) global competition; (b) environment and development; (c) configuration of petroleum resources; and (d) gradually increased profit margins. Compared to developed countries, however, there are still certain lags in terms of modernized management levels in China. In particular, with the introduction of computer techniques over the last ten years, the degree of automation in foreign countries has reached a higher lever, while China is still in the initial stage.

With deeper development of the oil field industry, most oil fields in China have entered the third stage of oil extraction. During this stage, oil well output decreases, water content increases, and costs are higher.

Through application of the automation system we provide, oil well head information such as indicator diagrams, current diagrams, oil pressure, oil temperature and the running status of oil wells, can be accurately passed on to management in real time. Management may see information in the clear human-machine interface and make analysis and decisions enabling the realization of remote controls over oil extraction wells such as auto delayed start-up of the oil extraction well after being switched on/off or intermittent extractions. The system can achieve failure protection and send timely alarms, for instance, the system is equipped with auto stop and alarms in the cases of blocking, breaking of oil extraction rods, and phase breaking to avoid the occurrence of major accidents. The measurement station can realize automatic measurement of liquid and gas and transfer the data to the central control room in real time. With this system, the oil well heads and measurement stations have no need to be monitored by

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personnel and in addition, in-time and accurate information transfers between the oil extraction well and management have improved labor productivity, brought down manual work and consumptions, lowered costs for oil extractions, eliminated failures in time, increased oil output, actualized automatic management for oil fields and integrated management above and under-ground. The automation system also provides full and accurate data for research and development of petroleum deposit projects as well as a reliable technical basis for oil field productions and decision-making.

Our automation system can also be used in connection with the delivery of liquefied natural gas. China is currently diversifying its energy sources, and China imported 15% more liquefied natural gas in 2008 than in 2007. Although the increase from 2.9 to 3.3 million tons for the full year was significant, our optimism about the future of liquefied natural gas in China (as well as the need for our services in the industry) is tempered by a 23% drop from November to December 2008, which coincided with the international market crisis.

Apart from the above-mentioned factors, increasingly intense competition in the oil field market, increasing efficiency by reducing redundant staff and reduction of cost is bound to facilitate the all-around generalization of the automation system.

Accordingly, any significant change in the general demand for oil and liquefied natural gas in China, the PRC government s policy or the strategies of major PRC energy companies may significantly affect the demand for our service and products and, as a result, our revenues and financial condition.

In addition, our oil well water finding/blocking technology, multipurpose fissure shaper, and high-efficiency heating furnace can increase the oil field output, decrease the water content, save energy, lower consumption, reduce the oil extraction cost, and strengthen the competitive force of the domestic oil fields.

Relevant Industry-Wide Factors. Management believes the Chinese oil field service industry, and in particular the oil field service market, is likely to experience rapid growth in the near future. This belief is based on management s experience in the industry and its analysis of the following recent trends:

Management believes that larger companies in China are becoming more sophisticated in managing and implementing their information systems. Management believes that these tendencies are likely to create a strong demand for software integration and customized system development from these larger companies. As a result, management believes that many oil field service providers will attempt to reposition their businesses as development services providers, rather than off-the-rack vendors. In the context of economic transformation, local manufacturers will likely face industrial restructuring as they try to grow to compete and fend off increased pressure from greatly shortened product lives. Management believes that the use of advanced information technologies in management and control of manufacture is becoming more important to success in the market.

Management believes that a significant number of Chinese manufactures, especially those in the oil and gas industry, still lack sufficient technical applications and services for their needs. These companies tend to be more cost-sensitive. Management believes that such clients would be more likely to use our service and products to reduce expenses by third-parties like us. Management believes this will be an increasingly competitive market.

Management also believes that high-tech and precise instruments will become increasingly prevalent in the oil field service market, as China continues to be more dependent on oil and as oil resources continue to decline.

Dependence on CNPC and Sinopec. We derive substantially all of our revenues from the operating subsidiaries of two customers, (i) CNPC and (ii) Sinopec.

We provide products and services to Sinopec under a series of agreements, each of which is terminable without notice. We first began to provide services to Sinopec in 1998. Sinopec accounted for approximately 33.84% and 49.02% of our revenues in 2008 and 2009, respectively, and any termination of our business relationships with Sinopec would materially harm our operations.

We provide products services to CNPC under a series of agreements, each of which is terminable without notice. We first began to provide services to CNPC in 2000. CNPC accounted for approximately 59.82% and 43.11% of our revenues in 2008 and 2009, respectively, and any termination of our business relationships with CNPC would materially harm our operations.

In order to grow and to protect our company against the risks associated with our dependence on CNPC and Sinopec, management intends to improve our service and expand our potential market. Management believes that a large number of Chinese petroleum companies are likely to require services and products such as those we provide.

Nature of Operations. Our technicians and solutions were developed with strong industrial expertise in the oil and gas industry. Products and services provided by us mainly include:

RSCADA System. Nanjing Recon s technology includes RSCADA, an industrial computerized process control system for monitoring, managing and controlling oil field service extraction. RSCADA integrates the underground, ground and above-ground levels of the oil field service extraction industry. RSCADA connects the above-ground level central control room with the ground level relay station and the relay station with the underground bottom intelligent terminal using the 2.4G wireless frequency. RSCADA has received grants and awards from the State Ministry of Science and Technology and the city of Nanjing.

Water System. In addition to RSCADA, BHD has developed and implemented technology designed to find and block water content in oil field service. As China s extraction of oil has increased, the quantity of available oil has decreased and the water content in remaining oil has increased. In order to improve our efficiency and profitability in extraction, we have developed technology to reduce the amount of water in our extracted oil field service.

Oil Field Furnaces. Crude oil field service contains certain impurities that must be removed before the oil field service can be sold, including water and natural gas. To remove the impurities and to prevent solidification and blockage in transport pipes, companies employ heating furnaces. BHD researched, developed and implemented a new oil field furnace that is advanced, highly automated, reliable, easily operable, and comparatively safe and highly heat efficient (90% efficiency).

Multipurpose Fissure Shaper. BHD has also developed a multipurpose fissure shaper to improve our ability to test for and extract oil field service. Before any oil field service extractor can test for the presence of oil, it must first perforate a hole for testing. The depth of the perforated hole is, of course, extremely important in the testing process: a hole that is too shallow may cause an extractor to miss an oil field entirely. We have developed a proprietary multipurpose fissure shaper that is used with the perforating gun to effectively increase the perforation depth by between 46 and 80%, shape a great number of stratum fissures, improve the stratum diversion capability and, as a result, improve our ability to locate oil fields and increase the output of oil wells.

As a technology development company, we put a priority on research, exploration, design and innovation. For years we have been increasing investments in attracting and training talents to continually improve our research and development capability. We currently have more than 90 employees, 80% of whom graduated from college. We also cooperate with the Oil Field Service & Geology Research Laboratory of Nanjing University.

Factors Affecting Our Results of Operations Generally

Our operating results in any period are subject to general conditions typically affecting the Chinese oil field service industry including:

- the amount of spending by our sophisticated customers, primarily those in the oil and gas industry;
- growing demand from large corporations for improved management and software designed to achieve such corporate performance;
- the procurement processes of our customers, especially those in the oil and gas industry;
- competition and related pricing pressure from other oil field service solution providers, especially those targeting the Chinese oil and gas industry;
- the ongoing development of the oil field service market in China; and
- inflation and other factors.

Unfavorable changes in any of these general conditions could negatively affect the number and size of the projects we undertake, the number of products we sell, the amount of services we provide, the price of our products and services and otherwise affect our results of operations.

Our operating results in any period are more directly affected by company-specific factors including:

- our revenue growth;
- the proportion of our business dedicated to large companies;

our ability to successfully develop, introduce and market new solutions and services;

our ability to increase our revenues to businesses, both old customers and new in Chinese oil and gas industry;

our ability to effectively manage our operating costs and expenses; and

our ability to effectively implement any targeted acquisitions and/or strategic alliances so as to provide efficient access to markets and industries in the Chinese oil and gas industry.

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Critical Accounting Policies and Estimates

Estimates and Assumptions. We prepare our financial statements in conformity with U.S. GAAP, which requires us to make judgments, estimates and assumptions. We continually evaluate these estimates and assumptions based on the most recently available information, our own historical experience and various other assumptions that we believe to be reasonable under the circumstances. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates. An accounting policy is considered critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time such estimate is made, and if different accounting estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the combined and consolidated financial statements. We believe that the following policies involve a higher degree of judgment and complexity in their application and require us to make significant accounting estimates. The following descriptions of critical accounting policies, judgments and estimates should be read in conjunction with our combined and consolidated financial statements and other disclosures included in this prospectus. Significant accounting estimates reflected in our Company s combined and consolidated financial statements include revenue recognition, allowance for doubtful accounts, and useful lives of property and equipment.

Revenue Recognition. We recognize revenue when it is realized and earned. We consider revenue realized or realizable and earned when (1) we have persuasive evidence of an arrangement, (2) delivery has occurred, (3) the sales price is fixed or determinable, and (4) collectability is reasonably assured. Delivery does not occur until products have been shipped or services have been provided to the client and the client has signed a completion and acceptance report, risk of loss has transferred to the client, client acceptance provisions have lapsed, or we have objective evidence that the criteria specified in client acceptance provisions have been satisfied. The sales price is not considered to be fixed or determinable until all contingencies related to the sale have been resolved.

Hardware. Revenue from hardware sales is generally recognized when the product is shipped to the customer and when there are no unfulfilled company obligations that affect the customer s final acceptance of the arrangement.

Services. The Company provides services to improve software functions and system requirements on separated fixed-price contracts. Revenue is recognized on the completed contract method when acceptance is determined by a completion report signed by the customer. Deferred revenue represents unearned amounts billed to customers related to service agreements.

Software. The Company sells self-developed software. For software sales, the Company recognizes revenues in accordance with the provisions of Statement of Position No. 97-2, Software Revenue Recognition, and related interpretations. Revenue from software is recognized according to project contracts. Contract cost are accumulated during the periods of installation and testing or commissioning. Usually this is short term. Profits are not recognized until completion of the contracts. Costs included in inventory as work in process include direct materials, labor and related expense. Corporate general and administrative expenses are charged to expense in the period they are incurred.

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Revenues applicable to multiple-element fee arrangements are divided among the elements such as software, hardware and post-contract service using vendor-specific objective evidence of fair value. Such evidence consists of pricing of multiple elements when those same elements are sold as separate products or arrangements. Software maintenance for the first year and initial training are included in the purchase price of the software. Initial training is provided at the time of installation and is recognized as income as part of the price of the software since it is minimal in value. Maintenance is valued based on the fee schedule used by us for providing the regular level of maintenance service as sold to customers when renewing their maintenance contracts on a standalone basis. Maintenance revenue is included in the income statement under services and is recognized over the term of the agreement.

Fair Values of Financial Instruments. The carrying amounts reported in the combined and consolidated balance sheets for trade accounts receivable, other receivables, advances to suppliers, trade accounts payable, accrued liabilities, advances from customer and notes payable approximate fair value because of the immediate or short-term maturity of these financial instruments.

Allowance for Doubtful Accounts. Trade receivables and other receivable accounts are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less a provision made for impairment of these receivables. Provisions are applied to trade and other receivables where events or change in circumstances indicate that the balance may not be collectible. The identification of doubtful debts requires the use of judgment and estimates of management. Our management must make estimates of the collectability of our accounts receivable. Management specifically analyzes accounts receivable, historical bad debts, customer creditworthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Our allowance for trade accounts receivable was ¥1,558,917 and ¥604,953 ($88,570) on June 30, 2008 and 2009, respectively. The decrease between 2008 and 2009 is due to: (1) the growth of our business with our large clients, which allowed us to reduce our estimate on uncollectible amounts of accounts receivable to reflect our current business risks; (2) our efforts to strengthen our management of accounts receivable to improve our cash flow management; and (3) the effective consolidation of our chain of capital. By the end of fiscal year 2009, most of our accounts receivable were aged less than one year. If the financial condition of our clients were to deteriorate, resulting in their inability to make payments, an additional allowance might be required.

Property and Equipment. We record property and equipment at cost. We depreciate property and equipment on a straight-line basis over their estimated useful lives using the following annual rates:

Motor Vehicles	10 years
Office Equipment	2-5 years
Leasehold Improvements	5 years

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We expense maintenance and repair expenditures as they do not improve or extend an asset s productive life. These estimates are reasonably likely to change in the future since they are based upon matters that are highly uncertain such as general economic conditions, potential changes in technology and estimated cash flows from the use of these assets.

Gains or losses on sales or retirements are included in the combined and consolidated statements of operations in the year of disposition. Depreciation expense was ¥195,624 and ¥321,300 ($47,041) for the years ended June 30, 2008 and 2009, respectively.

	Chinese Yuan (Renminbi)		U.S. Dollars
	June 30, 2008 (As Restated)	June 30, 2009 (Audited)	June 30, 2009 (Unaudited)
Motor vehicles	¥ 684,183	¥ 1,464,918	$ 214,476
Office equipment	777,301	779,257	114,090
Leasehold improvement		169,462	24,811
Total property and equipment	1,461,484	2,413,637	353,377
Less: Accumulated depreciation	(685,461)	(1,006,761)	(147,398)
Property and equipment, net	¥ 776,023	¥ 1,406,876	$ 205,979

Software Development Costs. We charge all of our development costs to research and development until we have established technological feasibility. We acknowledge technological feasibility of our software when a detailed program design has been completed, or upon the completion of a working model. Upon reaching technological feasibility, we capitalize additional software costs until the software is available for general release to customers. Although we have not established a budget or time table for software development, we anticipate the need to continue the development of our software products in the future and the cost could be significant. We believe that, as in the past, the costs of development will result in new products that will increase revenue and therefore justify costs. There is, however, a reasonable possibility that we may be unable to realize the carrying value of our software, and the amount not so realized may adversely affect our financial position, results of operation or liquidity in the future.

Cost of Revenue. Cost of our revenues includes wages, materials, handling charges, and other expenses associated with manufactured products and service provided to customers; the cost of purchased raw materials such as steel products and chemical materials. We expect cost of revenue to grow as our revenues grow. It is possible that we could incur development costs with little revenue recognition, but based upon our past history, we expect our revenues to grow.

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Valuation of Long-Lived Assets. We review the carrying values of our long-lived assets for impairment whenever events or changes in circumstances indicate that they may not be recoverable. When such an event occurs, we project undiscounted cash flows to be generated from the use of the asset and its eventual disposition over the remaining life of the asset. If projections indicate that the carrying value of the long-lived asset will not be recovered, we reduce the carrying value of the long-lived asset, by the estimated excess of the carrying value over the projected discounted cash flows. In the past, we have not had to make significant adjustments to the carrying values of our long-lived assets, and we do not anticipate a need to do so in the future. However, circumstances could cause us to have to reduce the value of our capitalized software more rapidly than we have in the past if our revenues were to significantly decline. Estimated cash flows from the use of the long-lived assets are highly uncertain and therefore the estimation of the need to impair these assets is reasonably likely to change in the future. Should the economy or acceptance of our software change in the future, it is likely that our estimate of the future cash flows from the use of these assets will change by a material amount. See Management s Discussion and Analysis or Plan of Operation -Property and Equipment and - Software Development Costs.

Results of Operations

Our historical reporting results are not necessarily indicative of the results to be expected for any future period.

Revenues. Our total revenues increased by approximately 15.06% or ¥9,898,673, from ¥65,748,234 in 2008 to ¥75,646,907 ($11,075,358) in 2009. In spite of the decrease of oil prices over the past year and the worldwide economic crisis, both of which companies, including our clients, more cautious about their finances, it also encouraged those companies to seek ways to reduce costs and maximize output by investing in technological solutions that would enable them to improve revenues and reduce expenses. Because our solutions are designed to help oil companies operate more efficiently, our customers ordered more of our products and services. As a result, we were able to continue to grow in a very difficult year for industry. In addition, this increase also resulted directly from our growing relationships with CNPC and Sinopec. Specifically, the Chinese government has attached great importance to the safety problems that exist in the Chinese energy industry by implementing numerous new projects and initiatives designed to increase safety and security in the Chinese energy industry. This replacement project is a Chinese reform project designed to eliminate hidden security dangers and develop key projects for saving energy and materials. As a result of the new policies, the Chinese government has increased spending to replace equipment with potential safety problems. As such, we have experienced increased sales and a greater demand for our maintenance services, which has increased our revenue. Additionally, as we have provided services to CNPC and Sinopec and our relationships have grown, they have chosen to continue to use our solutions. During the year ended June 30, 2008, substantially all of our revenues were generated through our business

engagements with the two largest Chinese oil companies. These significant engagements made it possible for us to improve our service quality, products popularity and adaptability for a very limited number of customers. Further, this long-term cooperation provides us more preferences for collecting receivables on time. We expect that our gross revenues will continue to increase over time as we:

- use the money we raised in our initial public offering to grow our Company;
- expand the adoption of our solutions into other markets outside the Chinese oil and gas industry; and
- introduce our solutions to businesses located outside of China.

Cost of Revenues. Our cost of revenues includes costs related to the design, implementation, delivery and maintenance of our software solutions and raw materials. We have set up service and maintenance centers in Xinjiang, Jidong, Qinghai district, and other locations which can provide our customers with technical consulting, repair and maintenance services. We purchase equipment based on each client s needs. Raw materials used to produce our hardware products consist largely of steel products and chemical products. Our cost of hardware increased slightly because some of our clients, especially subsidiaries of Sinopec, required more equipment that we purchase from others. We acted as an agent in these cases and we purchased equipment specified according to our customers. Because we did not produce this equipment, we could not control all of the costs associated with it, which led to the increase. Our cost of services decreased slightly because we are familiar with our market in Qinghai and Jidong area, two areas of growth for us in 2009, and were thus able to benefit from scale advantages. We may devote more into business with high margin, so our cost of revenues may be variable. We expect that our cost of revenues will increase as our revenues grow, but whether our cost of revenues increase as a percentage of revenues will depend on whether we are able to grow our higher margin areas of business.

Our cost of revenues increased from ¥39,771,955 in 2008 to ¥45,758,804 ($6,699,482) in 2009, an increase of 15.05%. As a percentage of revenues, our cost of revenues remained essentially the same in year 2008 and 2009.

Gross Profit. For the year ended June 30, 2009, our gross profit increased to ¥29,888,103 ($4,375,876) from ¥25,976,279 for the same period in 2008, an increase of ¥3,911,824, or approximately 15.06%. For the year ended June 30, 2009, our gross profit as a percentage of revenue remained essentially the same as in 2008.

Expenses.

General and Administrative Expenses. General and administrative expenses consist primarily of costs from our human resources organization, facilities costs, depreciation expenses, professional advisor fees, audit fees and other expenses incurred in connection with general operations. General and administrative expenses increased 42.28% or ¥1,662,177, from ¥3,931,205 in 2008 to ¥5,593,382 ($818,919) in 2009. General and

administrative expenses were 5.98% of total revenues in 2008 and 7.39% of total revenues in 2009. This result was primarily due to two factors: (1) we strengthened our management of claimed expenses and increased the allowance level of other receivable accounts. (2) we completed an assessment of our historical accounting practices. We have included this assessment as a current period expense. We expect that this assessment expense will be a one-time expense. As we continue to grow, we expect that our general and administrative expenses will increase. In addition, we expect that becoming an independent public company may create a short-term increase in general and administrative expenses as a percentage of revenues. Many of these costs are expected to be non-recurring as they relate primarily to the establishment of additional functions in connection with becoming a publicly-traded company.

Selling and Distribution Expenses. Selling and distribution expenses consist primarily of salaries and related expenditures of our sales and marketing organization; sales commissions; costs of our marketing programs, including public relations, advertising and trade shows; and an allocation of our facilities and depreciation expenses. Selling expenses increased by 5.92%, from ¥5,343,840 in 2008 to ¥5,660,198 ($828,702) in 2009. This increase resulted primarily from our business expansion activities. As we continued to solidify our business relationship with other companies, we required extensive marketing efforts and incurred the costs associated therewith. At present, we are expanding our business in Jidong and North West district. In order to successfully increase the scope of our client base, we expect that our selling expenses will correspondingly increase. Selling expenses were 8.13% of total revenues in 2008 and 7.48% of total revenues in 2009. This slight decrease resulted from the fact that during 2008 and 2009, we were able to generate additional revenues from our existing client base (CNPC and Sinopec) without increasing our marketing efforts. As we increase the scope of our client base over the next several years, we expect to see our selling expenses as a percentage of revenue increase as a result, in part, of our expanded marketing efforts. We expect that our marketing efforts will require a period of time before resulting in additional sales.

Income from Operations. Income from operations was ¥18,634,523 ($2,728,255) for the year ended June 30, 2009, an 11.58% increase from ¥16,701,234 for the same period in 2008. This increase in income from operations can be attributed primarily to the increase in sales volume to CNPC and Sinopec.

Subsidy Income. We received grants from the local government. For the year ended June 30, 2009, we received ¥2,038,015 ($298,383) subsidy income, a large increase compared to the year 2008. These grants were given by the government to support local software companies operation and research and development. Grants related to research and development projects are recognized as subsidy income in the combined and consolidated statements of operations when related expenses are recorded. We plan to arrange more research projects to continue to seek such subsidy income in the future.

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Income Tax Expense. Income taxes are provided based upon the liability method of accounting pursuant to SFAS No. 109, Accounting for Income Taxes. Under this approach, deferred income taxes are recorded to reflect the tax consequences on future years of differences between the tax basis of assets and liabilities and their financial reporting amounts. A valuation allowance is recorded against deferred tax assets if it is not likely that the asset will be realized. In June 2006, the Financial Accounting Standards Board issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). 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. FIN 48 also provides guidance on derecognition classification, interest and penalties, accounting in interim periods, disclosure, and transition. The interpretation is effective for the fiscal years beginning after December 15, 2006. The adoption of this interpretation had no material effect on the Company s financial statements.

We have not been subject to any income taxes in the United States or the Cayman Islands. Enterprises doing business in PRC are generally subject to federal (state) enterprise income tax at a rate of 30% and a local income tax at a rate of 3%; however, due to Nanjing Recon s location in a State Standard High Technology Development Zone, it was granted a certification of High Technology Enterprise and was taxed at a rate of 15% for taxable income generated and was 50% exempt from this income tax from 2005 to 2007. ENI is subject to a 25% earned income tax (EIT) rate. BHD also pays the statutory rate of 25%. We had minimal operations in jurisdictions other than the PRC. Income tax expense for years ended June 30, 2008 and 2009 were ¥4,665,897 and ¥3,677,887 ($538,474), respectively. This decrease resulted from (1) our ability to deduct certain expenses from our revenue according to a newly-released Chinese tax policy; and (2) the reduction of our effective EIT rate according to new Chinese tax laws. We expect that our effective EIT rate will vary, depending on which of our Domestic Companies generate greater revenues, as an increased percentage of revenues from ENI or BHD will result in our effective rate moving closer to BHD s and ENI s 25% rate and away from Nanjing Recon s 15% rate.

Interest Income. Our interest income represents the interest accrued as a result of bank deposits. Our interest income decreased from ¥18,963 in 2008 to ¥15,159 ($2,219) in 2009. We expect that our interest income will dramatically increase in the near future as we will earn interest on the proceeds of our initial public offering pending application thereof.

Income from Continuing Operations. As a result of the factors described above, income from continuing operation was ¥15,256,875 ($2,233,738) for the year in 2009, increased by ¥4,155,975, or 37.44%, from ¥11,100,900 for 2008.

Discontinued Operations. At the end of the fiscal year 2008, our Company completed the sale of Inner Mongolia Adar Energy Technology, Ltd. and Beijing Weigu Windows Co. which were both the majority-owned

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subsidiaries of BHD as well as Xiamen Recon Technology Development, Ltd., which was the majority-owned subsidiary of Nanjing Recon. In the fourth quarter of 2008, we determined that these three subsidiaries met the criteria for classification as discontinued operations. The gain on the disposal of these subsidiaries and the financial results associated with 2008 and prior periods are included in discontinued operations.

Net Income Available For Common Shareholders. As a result of the factors described above, net income available for common shareholders was ¥15,205,321 ($2,226,190) for the year in 2009, increased by ¥3,625,017, or 30.30%, from ¥11,580,304 for 2008.

Liquidity and Capital Resources.

General

Cash and Cash Equivalents. Cash and cash equivalents are comprised of cash on hand, demand deposits and highly liquid short-term debt investments with stated maturities of no more than three months. On June 30, 2009, we had cash and cash equivalents in the amount of ¥2,727,735 ($399,364). Our management believes that the revenues expected to be generated from operations along with the proceeds of our initial public offering will be sufficient to finance our operations for the foreseeable future. We expect that our ability to assume new, larger, more capital-intensive projects will require us to raise funds beyond those we currently possess. We believe our recently completed initial public offering will address these needs.

Indebtedness. As of June 30, 2009, except for ¥6,488,169 ($949,924) of notes payable, we did not have any other outstanding loan capital issued or agreed to be issued, bank overdrafts, loans, debt securities or similar indebtedness, liens, liabilities under acceptance (other than normal trade bills) or acceptance credits, debentures, mortgages, charges, finance leases or hire purchase commitments, guarantees or other material contingent liabilities. In addition, there has not been any material change in our indebtedness, commitments and contingent liabilities since June 30, 2009.

Holding Company Structure. We are a holding company with no operations of our own. All of our operations are conducted through our Chinese subsidiary. As a result, our ability to pay dividends and to finance any debt that we may incur is dependent upon dividends and other distributions paid. In addition, Chinese legal restrictions permit payment of dividends to us by our Chinese subsidiary only out of its accumulated net profit, if any, determined in accordance with Chinese accounting standards and regulations. Under Chinese law, our subsidiary is required to set aside a portion (at least 10%) of its after-tax net income (after discharging all cumulated loss), if any, each year for compulsory statutory reserve until the amount of the reserve reaches 50% of our subsidiaries registered capital. These funds may be distributed to shareholders at the time of its wind up. When we were incorporated in Cayman Island in August 2007, 5,000,000 ordinary shares were authorized, and 50,000 ordinary shares were issued to

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Mr. Yin Shenping, Mr. Chen Guangqiang and Mr. Li Hongqi, at a par value of $0.01 each. On December 10, 2007, our company sold 2,632 ordinary shares to an investor at an aggregate considery. 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.

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In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* (SFAS No. 161). SFAS No. 161 applies to all derivative instruments and nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 37 and 42 of Statement 133, and related hedged items accounted for under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133). SFAS No. 161 requires entities to provide greater transparency through additional disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, results of operations, and cash flows. This statement is effective for fiscal years beginning on or after November 15, 2008. Early adoption is encouraged. The adoption of this statement is not expected to have a significant impact on the Company s disclosures included in its consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position SFAS 142-3, *Determination of the Useful Life of Intangible Assets*, (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of FSP 142-3 on its consolidated financial position and results of operations.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. This statement is not expected to change existing practices but rather reduce the complexity of financial reporting. This statement will go into effect 60 days after the SEC approves related auditing rules.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. This FSP addresses whether instruments granted in share-based payment transactions may be participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing basic earnings per share (EPS) pursuant to the two-class method described in paragraphs 60 and 61 of SFAS No. 128, *Earnings Per Share*. A share-based payment award that contains a non-forfeitable right to receive cash when dividends are paid to common shareholders irrespective of whether that award ultimately vests or remains unvested shall be considered a participating security as these rights to dividends provide a non-contingent transfer of value to the holder of the share-based payment award. Accordingly, these awards should be included in the computation of basic EPS pursuant to the two-class method. The guidance in this FSP is effective for fiscal years beginning after December 15, 2008 and interim periods within those years. Early adoption is not permitted. All prior period EPS data will be adjusted retrospectively to reflect the provisions of the FSP. Under the terms of the Company s restricted stock awards, grantees are entitled to receive dividends on the unvested portions of their awards. There is no requirement to return these dividends in the event the unvested awards are forfeited in the future. Accordingly, this FSP will have an effect on the Company s EPS calculations and the Company will continue to evaluate the effects of this guidance.

(4) Dana Claim

On March 3, 2006, 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. 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 previously approved arbitration payments and enter into a new long-term supply contract running through 2014. 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.

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 3,090,408 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 Dana s reserves for those matters (estimated by the Company to represent an additional 739,000 shares) and the right to receive a distribution of cash. 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. On February 11, 2008, the Company received its initial distribution of common stock, and on March 18, 2008 the Company received its cash distribution totaling $6,891,188. On April 21, 2008 and July 30, 2008, the Company received 114,536 and 152,506 of DAN common shares, respectively, representing approximately 36% of the total 739,000 additional common shares the Company expects to receive.

The aforementioned cash distribution was recorded as a reduction in the Company s $76,483,000 recorded basis in the claim. Of the remaining $69,592,000, $56,162,000 was attributed to the initial distribution of shares received by the Company in February, 2008, $2,081,000 was attributed to the shares received by the Company in April, 2008, and $2,771,000 was attributed to the shares received by the Company in July, 2008. The remaining $8,578,000 is attributed to the 472,000 of additional shares expected to be received by the Company as additional distributions. If the Company ultimately receives fewer additional shares than expected, these allocations would be adjusted on a pro rata basis.

The Company accounts for its common stock in DAN in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS No. 115). The Company accounts for its shares as available-for-sale securities with associated unrealized holding gains or losses reported as a component of other comprehensive loss or income. The Company has not sold any of its common stock in DAN, and at September 28, 2008, the basis and fair value of the Company s holdings of DAN common stock amounted to $61,015,000 and $18,164,000, respectively. Unrealized holding losses recorded in other comprehensive loss totaled $38,673,000, net of income taxes of $4,178,000. See Note 6 for further information.

The Company believes that the price for Dana s common stock at September 28, 2008 is temporarily depressed. A number of market issues including sub-prime lending practices, tightening credit markets and recession concerns have driven market prices down. A substantial portion of the owners of DAN stock were contractually restricted from trading those shares through July of 2008, while many equity mutual funds remained restricted from purchasing stock in businesses that have recently emerged from bankruptcy. The automotive sector has been under considerable scrutiny due to bankruptcies, sharply declining light vehicle sales and significant losses recorded by major companies within the sector. At September 28, 2008, the Company believed that these negative factors were likely to begin to improve in the near term and that it possessed the ability and intent to hold its shares of Dana common stock until a full recovery of the current carrying value occurs. However, there can be no assurance that, under applicable accounting principles, unrealized holding losses will not be deemed other-than-temporary and be recognized through the Company s statement of operations in future periods, which could materially adversely affect the Company s business, results of operations and financial condition.

At September 28, 2008, the Company s right to participate in additional distributions of DAN common stock, presently estimated to be 472,000 additional shares, was carried at $8,578,000 in other assets. Had these shares been received at September 28, 2008, the Company would have recorded an additional $5,101,000 unrealized holding loss to other comprehensive loss, net of income taxes of $923,000. See Note 14 for further information.

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(5) (Loss) Earnings Per Common Share

There were no adjustments required to be made to net (loss) income for purposes of computing basic and diluted (loss) earnings per common share. A reconciliation of the weighted average shares outstanding used in the calculation of basic and diluted (loss) earnings per common share is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
	(Unaudited)		(Unaudited)	
Shares used to compute basic (loss) earnings per common share	18,369	18,314	18,354	18,196
Dilutive effect of equity awards		234		155
Shares used to compute diluted (loss) earnings per common share	18,369	18,548	18,354	18,351

(6) Investment in Marketable Securities

The valuation of our investment in DAN, a marketable security accounted for pursuant to SFAS No. 115, is classified as available-for-sale and measured at fair value as determined by a quoted market price. The related unrealized holding losses are currently excluded from operations and recorded in accumulated other comprehensive loss on the consolidated balance sheets. At September 28, 2008, the Company owned 3,357,450 shares of DAN with a market value of $5.41 per share, which resulted in an unrealized loss of $38,673,000, net of a deferred tax benefit of $4,178,000, included in accumulated other comprehensive loss as of such date. The deferred tax benefit is net of a valuation allowance of $2,387,000 associated with the unrealized capital loss portion for our foreign subsidiary, as the Company has no assurance of generating capital gains in the future in order to realize the tax benefit. The deferred tax benefit associated with the unrealized loss for our domestic operations has been fully reserved. At September 28, 2008, this decline was considered by the Company to be temporary (see Note 4). Realized gains and losses and declines in value judged to be other-than-temporary will be included in other expense (income), if and when recorded. In accordance with SFAS No. 157, the fair value of DAN shares was valued based on quoted market prices in active markets for identical shares.

The following table summarizes marketable securities as of September 28, 2008 (in thousands):

	Basis	Gross Unrealized Gain/(Loss)	Gross Realized Gain/(Loss)	Fair Value At Quoted Prices in Active Markets (Level 1)
Investment in marketable securities	$ 61,015	$ (42,851)	$	$ 18,164

(7) Inventory

Inventory consisted of the following (in thousands):

	September 28, 2008	December 31, 2007
	(Unaudited)	
Raw materials, including perishable tooling of $896 and $1,129 in 2008 and 2007, respectively	$ 19,201	$ 21,140
Work in process	12,380	12,815

Finished goods	7,076	7,439
Costs relating to long-term contracts and programs, net of amounts attributed to revenue recognized to date	37,103	39,936
Progress payments related to long-term contracts and programs	(1,531)	(2,565)
Reserve for excess and obsolete inventory	(5,642)	(6,976)
	$ 68,587	$ 71,789

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(8) Segment Data

The Company is 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. There was no intersegment net revenue recognized in any of the periods presented. The following table presents financial information for the reportable segments of the Company (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
	(Unaudited)		(Unaudited)	
Net revenue from unaffiliated customers:				
Industrial Group	$ 57,969	$ 67,595	$ 196,884	$ 220,186
Aerospace & Defense	28,123	23,604	78,558	72,655
Test & Measurement	14,065	13,321	41,327	39,365
Electronics Group	42,188	36,925	119,885	112,020
	$ 100,157	$ 104,520	$ 316,769	$ 332,206
Gross profit:				
Industrial Group	$ 306	$ 4,713	$ 12,468	$ 13,782
Aerospace & Defense	2,841	2,471	7,377	6,403
Test & Measurement	3,508	3,288	10,613	9,995
Electronics Group	6,349	5,759	17,990	16,398
	$ 6,655	$ 10,472	$ 30,458	$ 30,180
Operating (loss) income:				
Industrial Group	$ (2,487)	$ 8,271	$ 4,125	$ 12,622
Aerospace & Defense	(1,599)	(660)	(4,344)	(3,548)
Test & Measurement	606	311	1,954	1,709
Electronics Group	(993)	(349)	(2,390)	(1,839)
General, corporate and other	(1,931)	(3,721)	(6,610)	(9,520)
	$ (5,411)	$ 4,201	$ (4,875)	$ 1,263

	September 28, 2008 (Unaudited)	December 31, 2007
Total assets:		
Industrial Group	$ 213,494	$ 264,182
Aerospace & Defense	95,058	108,189
Test & Measurement	31,026	30,337
Electronics Group	126,084	138,526
General, corporate and other	19,484	19,352
	$ 359,062	$ 422,060

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(9) Commitments and Contingencies

The provision for estimated warranty costs is recorded at the time of sale and periodically adjusted to reflect actual experience. A summary of changes in the warranty accrual, which is included in accrued liabilities in the accompanying balance sheets, is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
	(Unaudited)		(Unaudited)	
Balance at the beginning of the period	$ 476	$ 226	$ 522	$ 242
Accruals for warranties for products sold in the period	167	154	468	344
Fulfillment of warranty obligations	(220)	(143)	(542)	(349)
Revisions of estimated obligations			(25)	
Balance at the end of the period	$ 423	$ 237	$ 423	$ 237

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

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

As of September 28, 2008, the Company had outstanding purchase commitments of approximately $32,851,000, primarily for the acquisition of inventory and manufacturing equipment. As of September 28, 2008, the Company also had outstanding letters of credit approximating $1,896,000 primarily under a captive insurance program.

(10) Income Taxes

The provision for income taxes includes federal, state, local and foreign taxes. The Company s effective tax rate varies from period to period due to the proportion of foreign and domestic pre-tax income expected to be generated by the Company. The Company expects to generate income in 2008 from its foreign operations, which are taxed at a 28% statutory rate. The Company expects to generate a loss in 2008 from its domestic operations, which are subject to a federal statutory rate of 35%. It is anticipated that the Company will record a valuation allowance against a large portion of the deferred tax asset generated by the domestic operating loss. Reconciling items between the federal statutory rate and the effective tax rate include state income taxes, valuation allowances, provision to return differences and other permanent differences.

The Company recognizes liabilities or assets for the deferred tax consequences of temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS No. 109). These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of assets or liabilities are recovered or settled. SFAS No. 109 requires that a valuation allowance be established when it is more likely than not that all or a portion of a deferred tax asset will not be realized. The Company evaluates its deferred tax position on a quarterly basis and valuation allowances are provided as necessary. During this evaluation, the Company reviews its forecast of income in conjunction with other positive and negative evidence surrounding the realizability of its deferred tax assets to determine if a valuation allowance is needed. Based on the Company s current forecast, a valuation allowance of $4,067,000 was recorded through earnings for the nine months ended September 28, 2008; however,

there can be no assurances that the Company s forecasts are now, or in the future will be, accurate or that other factors impacting this deferred tax asset will not materially and adversely affect its business, results of operations and financial condition.

The Company s Mexican subsidiary is currently under a routine audit by the Mexican Servicio de Administracion Tributaria (SAT), the Mexican taxing authority, for the periods from May 27, 2004 through July 20, 2007. Proposed audit adjustments, if any, could significantly impact the Company s operating results.

(11) Employee Benefit Plans

Pension benefit consisted of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
	(Unaudited)		(Unaudited)	
Service cost	$ 4	$ 14	$ 54	$ 70
Interest cost on projected benefit obligation	549	525	1,709	1,621
Net amortizations, deferrals and other costs	1	24	55	126
Expected return on plan assets	(800)	(777)	(2,426)	(2,327)
	$ (246)	$ (214)	$ (608)	$ (510)

(12) Other Comprehensive Loss

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

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

	Three Months Ended		Nine Months Ended	
	September 28, 2008	September 30, 2007	September 28, 2008	September 30, 2007
	(Unaudited)		(Unaudited)	
Net (loss) income	$ (7,756)	$ 2,637	$ (8,306)	$ 91
Other comprehensive loss:				
Unrealized loss on available-for-sale securities, net of tax of $276 and $4,178 for the three and nine months ended September 28, 2008, respectively	(1,799)		(38,673)	
Foreign currency translation adjustments	(1,885)	(294)	485	(422)
Total comprehensive (loss) income	$ (11,440)	$ 2,343	$ (46,494)	$ (331)

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

	September 28, 2008 (Unaudited)	December 31, 2007
Foreign currency translation adjustments	$ 1,012	$ 527
Unrealized loss on available-for-sale securities, net of tax	(38,673)	
Employee benefit related adjustments, net of tax	(4,470)	(4,470)
Accumulated other comprehensive loss	$ (42,131)	$ (3,943)

On September 28, 2008 the Company was in compliance with its debt covenants. Such covenants include minimum net worth requirements exclusive of charges to accumulated other comprehensive loss. If the unrealized loss on available-for-sale securities related to the Company s investment in DAN common stock (see Notes 4 and 6) had been recorded through earnings at September 28, 2008, a violation of the minimum net worth covenant would have resulted.

(13) Nonrecurring Items

Nonrecurring items in 2008 include severance and information technology costs related to the decision to merge Sypris Electronics and Sypris Data Systems into a single organization within the Aerospace & Defense segment. Nonrecurring items in 2007 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.

(14) Subsequent Events

On October 10, 2008, the Company received 384,931 common shares of DAN representing approximately 82% of the total 472,000 additional common shares the Company expected to receive as of September 28, 2008 (see Note 4). The Company expects to receive approximately 87,000 additional shares of future distributions, subject to certain settlements by the Dana Corporation bankruptcy estate.

On October 10, 2008, the Board of Directors approved a plan to close the Company s Kenton, Ohio facility. The Kenton, Ohio facility currently employs approximately 117 people. The plan includes the relocation of certain production to the Company s Morganton, North Carolina facility which will begin to transition during the fourth quarter of 2008. Transition of the operation is expected to be completed by the second quarter of 2009.

Since September 28, 2008, the Dow Jones Industrial average has fallen from 11,143 to as low as 8,176 on October 27, 2008. A number of major financial institutions have failed, merged or received involuntary infusions of cash from the United States Treasury Department. The environment for obtaining commercial loans and other forms of debt financing has changed dramatically. Given the rapid pace of regulatory change as well as economic volatility, we are continuing to evaluate the ultimate impact of these developments on our financial condition, estimates, reserves or other aspects of our businesses.

As of November 3, 2008, the closing price for DAN common stock was $2.09 per share. Should the price for DAN stock remain at the November 3, 2008 price and the decline in value be considered other-than-temporary , the Company would be required to take a charge of $56.3 million, net of $5.3 million of income taxes, through its results of operations. Such a charge would likely result in a violation of the Company s minimum net worth covenants under its Revolving Credit Facility and Senior Notes as of December 31, 2008, based on current financial projections. In the event of such an occurrence, the Company would seek a waiver from its current creditors. There can be no assurance that in such an event a waiver could be obtained from the Company s current creditors or if so it would be on terms satisfactory to the Company.

On October 27, 2008, the Company gave notice of its intent to terminate the lease of its 26,300 square foot facility in San Dimas, California. Under the terms of the lease, the Company had a one-time right to terminate the lease at its mid-point in exchange for a $915,000 termination fee. The termination fee, payable in June 2009, will be recorded as a charge to the statement of operations in the fourth quarter consistent with requirements of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*.

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

Results of Operations

The tables presented below, which compare our results of operations for the three and nine month periods from 2008 to 2007, present the results for each period, the change in those results from 2008 to 2007 in both dollars and percentage change and the results for each period as a percentage of net revenue. The columns present the following:

The first two data columns in the tables show the absolute results for each period presented.

The columns entitled Year Over Year Change and Year Over Year Percentage Change show the change in results, both in dollars and percentages. These two columns show favorable changes as positive and unfavorable changes as negative. For example, when our net revenue increases from one period to the next, that change is shown as a positive number in both columns. Conversely, when expenses increase from one period to the next, that change is shown as a negative number in both columns.

The last two columns in the tables show the results for each period as a percentage of net revenue. In these two columns, the cost of sales and gross profit for each are given as a percentage of that segment s net revenue. These amounts are shown in italics.

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

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Three Months Ended September 28, 2008 Compared to Three Months Ended September 30, 2007

	Three Months Ended		Year Over Year Change	Year Over Year Percentage Change	Results as Percentage of Net Revenue for the Three Months Ended	
	Sept. 28, 2008	Sept. 30, 2007	Favorable (Unfavorable)	Favorable (Unfavorable)	Sept. 28, 2008	Sept. 30, 2007
			(in thousands, except percentage data)			
Net revenue:						
Industrial Group	$ 57,969	$ 67,595	$ (9,626)	(14.2)%	57.9%	64.7%
Aerospace & Defense	28,123	23,604	4,519	19.1	28.1	22.6
Test & Measurement	14,065	13,321	744	5.6	14.0	12.7
Electronics Group	42,188	36,925	5,263	14.3	42.1	35.3
Total	100,157	104,520	(4,363)	(4.2)	100.0	100.0
Cost of sales:						
Industrial Group	57,663	62,882	5,219	8.3	*99.5*	*93.0*
Aerospace & Defense	25,282	21,133	(4,149)	(19.6)	*89.9*	*89.5*
Test & Measurement	10,557	10,033	(524)	(5.2)	*75.1*	*75.3*
Electronics Group	35,839	31,166	(4,673)	(15.0)	*85.0*	*84.4*
Total	93,502	94,048	546	0.6	93.4	90.0
Gross profit:						
Industrial Group	306	4,713	(4,407)	(93.5)	*0.5*	*7.0*
Aerospace & Defense	2,841	2,471	370	15.0	*10.1*	*10.5*
Test & Measurement	3,508	3,288	220	6.7	*24.9*	*24.7*
Electronics Group	6,349	5,759	590	10.2	*15.0*	*15.6*
Total	6,655	10,472	(3,817)	(36.4)	6.6	10.0
Selling, general and administrative	10,431	10,369	(62)	(0.6)	10.4	9.9
Research and development	938	608	(330)	(54.3)	0.9	0.6
Amortization of intangible assets	42	129	87	67.4		0.1
Nonrecurring expense	655	(4,835)	(5,490)	NM	0.7	(4.6)
Operating (loss) income	(5,411)	4,201	(9,612)	NM	(5.4)	4.0
Interest expense, net	1,093	991	(102)	(10.3)	1.1	0.9
Other expense (income), net	1,050	(26)	(1,076)	NM	1.0	
(Loss) income before income taxes	(7,554)	3,236	(10,790)	NM	(7.5)	3.1
Income tax expense	202	599	397	66.3	0.2	0.6
Net (loss) income	$ (7,756)	$ 2,637	$ (10,393)	NM	(7.7)%	2.5%

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Nine Months Ended September 28, 2008 Compared to Nine Months Ended September 30, 2007

	Nine Months Ended		Year Over Year Change	Year Over Year Percentage Change	Results as Percentage of Net Revenue for the Nine Months Ended	
	Sept. 28, 2008	Sept. 30, 2007	Favorable (Unfavorable)	Favorable (Unfavorable)	Sept. 28, 2008	Sept. 30, 2007
			(in thousands, except percentage data)			
Net revenue:						
Industrial Group	$ 196,884	$ 220,186	$ (23,302)	(10.6)%	62.2%	66.3%
Aerospace & Defense	78,558	72,655	5,903	8.1	24.8	21.9
Test & Measurement	41,327	39,365	1,962	5.0	13.0	11.8
Electronics Group	119,885	112,020	7,865	7.0	37.8	33.7
Total	316,769	332,206	(15,437)	(4.6)	100.0	100.0
Cost of sales:						
Industrial Group	184,416	206,404	21,988	10.7	*93.7*	*93.7*
Aerospace & Defense	71,181	66,252	(4,929)	(7.4)	*90.6*	*91.2*
Test & Measurement	30,714	29,370	(1,344)	(4.6)	*74.3*	*74.6*
Electronics Group	101,895	95,622	(6,273)	(6.6)	*85.0*	*85.4*
Total	286,311	302,026	15,715	5.2	90.4	90.9
Gross profit:						
Industrial Group	12,468	13,782	(1,314)	(9.5)	*6.3*	*6.3*
Aerospace & Defense	7,377	6,403	974	15.2	*9.4*	*8.8*
Test & Measurement	10,613	9,995	618	6.2	*25.7*	*25.4*
Electronics Group	17,990	16,398	1,592	9.7	*15.0*	*14.6*
Total	30,458	30,180	278	0.9	9.6	9.1
Selling, general and administrative	31,485	29,740	(1,745)	(5.9)	9.9	9.0
Research and development	3,022	2,001	(1,021)	(51.0)	1.0	0.6
Amortization of intangible assets	171	457	286	62.6		0.1
Nonrecurring items	655	(3,281)	(3,936)	NM	0.2	(1.0)
Operating (loss) income	(4,875)	1,263	(6,138)	NM	(1.5)	0.4
Interest expense, net	3,068	2,624	(444)	(16.9)	1.0	0.8
Other expense, net	134	15	(119)	(793.3)		
Loss before income taxes	(8,077)	(1,376)	(6,701)	(487.0)	(2.5)	(0.4)
Income tax expense (benefit)	229	(1,467)	(1,696)	(115.6)	0.1	(0.4)
Net (loss) income	$ (8,306)	$ 91	$ (8,397)	NM	(2.6)%	%

Backlog. At September 28, 2008, backlog for our Aerospace & Defense segment decreased $2.7 million to $102.0 million from $104.7 million at September 30, 2007, on a 2% decrease in net orders to $81.4 million in the nine months ended September 28, 2008 compared to $83.1 million in net orders in the first nine months of 2007. Backlog for our Test & Measurement segment increased $1.3 million to $7.3 million at September 28, 2008, on $40.9 million in net orders compared to $39.8 million in net orders for the first nine months of 2007. We expect to

convert approximately 84% of the Aerospace & Defense backlog and 100% of the Test & Measurement backlog at September 28, 2008 to revenue during the next twelve months.

Net Revenue. The Industrial Group derives its revenue from manufacturing services and product sales. Net revenue in the Industrial Group decreased $9.6 million and $23.3 million from the prior year third quarter and nine month periods, respectively. Depressed market conditions for light trucks, commercial vehicles and trailers have contributed to volume related reductions in net revenue of approximately $12.9 million and $40.5 million for the third quarter and nine month periods, respectively. Partially offsetting the volume change is an increase in steel prices, which is contractually passed through to customers under certain contracts, resulting in an increase in net revenue of $5.6 million and $14.6 million for the third quarter and nine month periods, respectively. The Industrial

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Group also realized a decrease in net revenue of $2.3 million for the third quarter as a result of lower revenue from contractual settlements and pricing as compared to the prior year period. Net revenue for the nine months ended September 28, 2008 increased approximately $2.6 million over the prior year as a result of contractual settlements with certain customers and other pricing related changes.

The Aerospace & Defense segment derives its revenue from product sales and technical outsourced services. Net revenue in the Aerospace & Defense segment increased $4.5 million and $5.9 million for the third quarter and nine month periods, respectively, primarily due to increased sales of link encryption products. Offsetting this was a reduction in sales of certain data recording products of $0.9 million and $4.5 million, respectively for the three and nine months ended September 28, 2008.

The Test & Measurement segment derives its revenue from technical services and product sales. Technical services revenue accounted for approximately 86% of total Test & Measurement revenue in the nine months of 2008 compared to 89% for the nine months of 2007. Test & Measurement segment net revenue increased $0.7 million from the prior year third quarter primarily as a result of a $0.9 million increase in sales of magnetic meters and sensors, partially offset by a $0.4 million decrease in component screening services. Net revenue increased $2.0 million for the nine months ended September 28, 2008 primarily due to a $1.1 million increase in sales of magnetic meters and sensors and a $0.8 million increase in calibration services.

Gross Profit. The Industrial Group s gross profit of $0.3 million and $12.5 million in the third quarter and nine month periods of 2008, respectively, decreased from $4.7 million and $13.8 million in the third quarter and nine month periods of 2007, respectively, primarily as a result of decreased sales volumes, higher utilities and higher labor and related costs. This was partially offset by various productivity improvements made during the periods.

The Industrial Group s gross profit as a percentage of revenue decreased to 0.5% from 7.0% for the third quarter of 2008 but remained flat at 6.3% for the nine month periods of 2008 and 2007, respectively. The depressed market conditions in the light truck, commercial vehicle and trailer markets are expected to continue into the fourth quarter of 2008, and we anticipate the corresponding volume decline for our business will result in lower net revenues and gross profits for the Industrial Group for the remainder of 2008.

The Aerospace & Defense segment s gross profit increased $0.4 million and $1.0 million for the third quarter and nine month periods of 2008, respectively, primarily due to increased revenues. Gross profit as a percentage of revenue in the third quarter of 2008 decreased to 10.1% from 10.5%. For the nine month periods ended, gross profit as a percentage of revenue improved to 9.4% in 2008 from 8.8% in 2007.

The Test & Measurement segment s gross profit increased 6.7% or $0.2 million and 6.2% or $0.6 million for the third quarter and nine month periods of 2008, respectively. The improvement in gross profit for both periods is primarily due to the increased sales volume and the impact of productivity initiatives partially offset by cost inflation. Gross profit as a percentage of revenue also increased to 24.9% and 25.7% for the third quarter and nine month periods of 2008 from 24.7% and 25.4% for the third quarter and nine month periods of 2007, respectively.

Selling, General and Administrative. Selling, general and administrative expense increased $0.1 million and $1.7 million for the third quarter and nine month periods of 2008, respectively, primarily due to higher labor and related costs.

Research and Development. Research and development costs during the third quarter and nine month periods ended September 28, 2008 increased from the prior year periods primarily due to new product development efforts for a next generation secured communications device within our Aerospace & Defense segment.

Nonrecurring Expense, Net. Nonrecurring items in 2008 include severance and information technology costs related to the decision to merge Sypris Electronics and Sypris Data Systems into a single organization within the Aerospace & Defense segment. Nonrecurring items in 2007 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. Interest expense for the third quarter and nine months ended September 28, 2008 increased primarily due to an increase in the weighted average debt outstanding. Our weighted average debt

outstanding increased to $57.0 million and $55.4 million for the third quarter and nine month periods of 2008, respectively, from $50.8 million and $52.3 million during the third quarter and nine month periods of 2007. The weighted average interest rate was 6.4% and 6.7% for the third quarter and nine month periods of 2008, respectively, compared to 7.3% and 6.6% for the third quarter and nine month periods of 2007.

Other Expense (Income), Net. Other expense, net increased $1.1 million and $0.1 million for the third quarter and nine month periods ended September 28, 2008, primarily due to foreign currency transaction losses of $1.0 million and $0.3 respectively, while such amounts in the prior year periods were not significant.

Income Taxes. The provision for income taxes in the third quarter and nine month periods of 2008 includes a valuation allowance on the deferred tax assets generated by domestic operating losses. The requirement for a valuation allowance limits the domestic tax benefit recognized in 2008 and, when combined with the tax expense recorded on the profitable Mexico operations, results in a tax expense on the consolidated pre-tax loss for the quarter and nine months ended September 28, 2008.

Liquidity, Capital Resources and Financial Condition

Net cash provided by operating activities was $10.1 million in the first nine months of 2008, as compared to $3.3 million net cash used in 2007. Accounts receivable decreased in 2008 and provided $2.9 million, as a result of a continued emphasis on collections with significant customers. Inventory decreased in 2008 and provided $1.9 million, primarily due to volume reductions in the Industrial Group. Other current assets decreased in 2008 and provided $6.2 million, primarily due to a $6.9 million receipt associated with the Dana settlement. Accounts payable increased in 2008 and provided $8.1 million primarily due to the timing of disbursements for inventory and capital expenditures. Accrued liabilities decreased in 2008 and used $13.4 million, primarily due to a $9.5 million payment for the 2007 Mexico income tax liability. Other noncash items in 2008 include the amortization of deferred revenue attributable to the Dana settlement.

Net cash used in investing activities increased $3.1 million to $8.4 million for the first nine months of 2008, primarily due to higher capital expenditures.

Net cash used in financing activities was $1.7 million in the first nine months of 2008, as compared to $7.4 million in the first nine months of 2007, primarily due to additional payments on debt of $5.0 million in the prior year period.

We had total borrowings under our Revolving Credit Agreement of $35.0 million at September 28, 2008 and an unrestricted cash balance of $14.6 million. Approximately $2.8 million of the unrestricted cash balance relates to our Mexican subsidiaries. Maximum borrowings on the Revolving Credit Agreement are $50.0 million, with $50.0 million of additional borrowings available upon lead bank approval. Standby letters of credit up to a maximum of $15.0 million may be issued under the Revolving Credit Agreement of which $1.9 million were issued at September 28, 2008.

As of September 28, 2008, our principal commitment under the Revolving Credit Agreement is due in October 2009, while our principal commitment under the Senior Notes is $4.1 million, $15.0 million and $10.9 million due in 2009, 2011 and 2012, respectively. We also had purchase commitments totaling approximately $32.9 million at September 28, 2008, primarily for inventory and manufacturing equipment.

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 to renegotiate our current Revolving Credit Agreement and Senior Notes or to retire both of these obligations in connection with the execution of new debt financing agreements. 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.

On September 28, 2008 the Company was in compliance with its debt covenants. As of November 3, 2008, the closing price for DAN common stock was $2.09 per share. Should the price for DAN stock remain at the

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November 3, 2008 price and the decline in value be considered other-than-temporary , the Company would be required to take a charge of $56.3 million, net of $5.3 million of income taxes, through its results of operations. Such a charge would likely result in a violation of the Company s minimum net worth covenants under its Revolving Credit Agreement and Senior Notes as of December 31, 2008, based on current financial projections. In the event of such an occurrence, the Company would seek a waiver from its current creditors. There can be no assurance that in such an event a waiver could be obtained from the Company s current creditors or if so it would be on terms satisfactory to the Company.

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, if we do not remain in compliance with applicable covenants in any debt or other financing obligations 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.

Critical Accounting Policies

See the information concerning our critical accounting policies included under Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operation Critical Accounting Policies in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007. There have been no significant changes in our critical accounting policies during the nine month period ended September 28, 2008, except for the treatment of securities impairment, for which our new policy is outlined below.

As of September 28, 2008, we accounted for all of our marketable securities as available-for-sale. We evaluate our available-for-sale securities for other-than-temporary impairment under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS No. 115). SFAS No. 115 requires an investor to determine when an investment is considered impaired (i.e., the fair value is below its cost), evaluate whether the impairment is other-than-temporary (i.e., the investment value will not be recovered over its remaining life), and, if the impairment is other-than-temporary, recognize an impairment loss equal to the difference between the investment s cost and its fair value. The guidance also includes accounting considerations subsequent to the recognition of other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments.

The Company s available-for-sale securities are carried at estimated fair value, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income/loss in stockholders equity. The fair value of securities in the portfolio is based on published or securities dealers market values. The Company periodically reviews and evaluates the securities portfolio to determine if the decline in the fair value is other-than-temporary. If such a decline is deemed to be other-than-temporary, the security is written down to a new cost basis, and the resulting loss is charged to earnings. At September 28, 2008, the Company carried no other-than-temporarily impaired securities.

Forward-looking Statements

This quarterly 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 developments. 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 those views and assumptions have changed. There can be no assurance that our expectations, projections or views will come to pass, and undue reliance should not be placed on these forward-looking statements.

A number of significant factors could materially affect our specific business operations and cause our performance to differ materially from any future results projected or implied by our prior statements. Many of these

factors are identified in connection with the more specific descriptions contained throughout this report. Other factors which could also materially affect such future results currently include: our ability to liquidate our equity interests in Dana Holding Corporation (NYSE:DAN) at satisfactory valuation levels[1]; potential impairments, non-recoverability or write-offs of goodwill, assets or deferred costs, including deferred tax assets in the U.S.; fees, costs or other dilutive effects of refinancing, compliance with covenants in, or acceleration of, our loan and other debt agreements; costs and inefficiencies of restructuring our manufacturing capacity; breakdowns, relocations or major repairs of machinery and equipment; our inability to successfully launch new or next generation programs; the cost, efficiency and yield of our operations and capital investments, including working capital, production schedules, cycle times, scrap rates, injuries, wages, overtime costs, freight or expediting costs; cost and availability of raw materials such as steel, component parts, natural gas or utilities; volatility of our customers forecasts, financial conditions, market shares, product requirements or scheduling demands; cyclical or other downturns; adverse impacts of new technologies or other competitive pressures which increase our costs or erode our margins; failure to adequately insure or to identify environmental or other insurable risks; inventory valuation risks including obsolescence, shrinkage, theft, overstocking or underbilling; changes in government or other customer programs; reliance on major customers or suppliers, especially in the automotive or aerospace and defense electronics sectors; revised contract prices or estimates of major contract costs; dependence on, recruitment or retention of key employees; union negotiations; pension valuation, health care or other benefit costs; labor relations; strikes; risks of foreign operations; currency exchange rates; the costs and supply of debt, equity capital, or insurance (including the possibility that our common stock could cease to qualify for listing on the NASDAQ Stock Market due to a sustained decline in prices per share, or that any reverse stock split or other restructuring of our debt or equity financing could be accompanied by the deregistration of our common stock or other going private transactions); changes in licenses, security clearances, or other legal rights to operate, manage our work force or import and export as needed; weaknesses in internal controls; the costs of compliance with our auditing, regulatory or contractual obligations; regulatory actions or sanctions; disputes or litigation, involving customer, supplier, creditor, stockholder, product liability, asbestos-related or environmental claims; war, terrorism or political uncertainty; unanticipated or uninsured disasters, losses or business risks; inaccurate data about markets, customers or business conditions; or unknown risks and uncertainties and the risk factors disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

In this quarterly report, we may rely on and refer to information and statistics regarding the markets in which we compete. We obtained this information and these statistics from various third party sources and publications that are not produced for the purposes of securities offerings or reporting or economic analysis. We have not independently verified the data and cannot assure the accuracy of the data we have included.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks, including changes in interest rates, foreign currency exchange rates and prices for equity securities.

Interest Rate Risk

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 September 28, 2008) 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 September 28, 2008. A change in fixed interest rates of 100 basis points would change the fair value of our Senior Notes by $1.0 million. 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.

[1] *As of September 28, 2008, we had received distributions of approximately 3.4 million shares of DAN common stock. Due to market conditions and certain other factors, we believe that the recent trading prices of DAN common stock do not reflect its longer-term value. However, if we sell these shares at current prices or such prices otherwise reflect a decline in value which is deemed to be other than temporary or otherwise beyond our ability to hold these shares until their prices have recovered our business, results of operations, covenants in our loan and other debt agreements, cash flows and financial condition could be materially adversely impacted.*

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Foreign Exchange Risk

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 $0.2 million on an annualized basis, based upon the U.S. dollar denominated accounts of our foreign subsidiary at September 28, 2008. For the third quarter and nine months ended September 28, 2008, other income, net includes foreign currency transaction losses of $1.0 million and $0.3 million, respectively. Similar amounts for 2007 were not significant.

Equity Price Risk

With respect to our ownership of common stock in DAN, we are also subject to equity price risk. The Company received approximately 3.1 million shares of DAN common stock in its initial distribution from the bankruptcy estate on February 11, 2008 and received an additional 0.1 million and 0.2 million shares on April 21, 2008 and July 30, 2008, respectively. 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 September 28, 2008 by approximately $3.8 million.

ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of disclosure controls and procedures.* Based on the evaluation of our disclosure controls and procedures (as defined in Securities Exchange Act of 1934 Rules 13a-15(e) or 15d-15(e)) required by Securities Exchange Act Rules 13a-15(b) or 15d-15(b), our Chief Executive Officer and our Chief Financial Officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective.

(b) *Changes in internal controls*. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

Our common stock is currently listed on the NASDAQ Global Market. In the future, the Company may not be able to meet the continued listing requirements of NASDAQ. The continued listing requirements on NASDAQ require, among other things, that the average closing price of common stock be not less than $1.00 for 30 consecutive trading days. Since September 28, 2008, the Dow Jones Industrial average has fallen from 11,143 to as low as 8,176 on October 27, 2008. A number of major financial institutions have failed, merged or received involuntary infusions of cash from the United States Treasury Department. The environment for obtaining commercial loans and other forms of debt financing has changed dramatically. Given the rapid pace of regulatory change as well as economic volatility, we are continuing to evaluate the ultimate impact of these developments on our financial condition, estimates, reserves or other aspects of our businesses.

For additional information regarding factors that could affect the Company s results of operations, financial condition and cash flows, see the risk factors discussed in MD&A Forward-Looking Statements, in Part I Item 2 of this Form 10-Q and in Part I Item 1A of our Report on Form 10-K for the fiscal year ended December 31, 2007.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On August 1, 2008, and August 29, 2008, the restrictions on 17,000 and 4,310 restricted shares expired, respectively. As a result, 5,501 and 1,001 shares, respectively, were withheld by the Company for payment of employee payroll taxes related to such vesting. Common shares repurchased were immediately cancelled. The following table summarizes our repurchases during the third quarter ended September 28, 2008:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as a Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
August 1, 2008	5,501	$ 3.61		$
August 29, 2008	1,001	$ 2.25		$

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number	**Description**
4.1	Notice of Removal of Rights Agent and Appointment of Successor Rights Agent and Amendment No. 1 to the Rights Agreement effective as of September 8, 2008.
10.1	Agreement to Sixth Renewal of Lease between Sweetwell Industries Associates, L.P. and Group Technologies Corporation dated August 13, 2008, regarding Tampa industrial park property.
31(i).1	CEO certification pursuant to Section 302 of Sarbanes - Oxley Act of 2002.
31(i).2	CFO certification pursuant to Section 302 of Sarbanes - Oxley Act of 2002.
32	CEO and CFO certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes - Oxley Act of 2002.

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SIGNATURES

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

		SYPRIS SOLUTIONS, INC. (Registrant)
Date: November 5, 2008	By:	/s/ Brian A. Lutes (Brian A. Lutes) Vice President & Chief Financial Officer
Date: November 5, 2008	By:	/s/ M. Glen French (M. Glen French) Controller (Principal Accounting Officer)

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