

OLYMPIC STEEL INC  
Form 10-Q  
October 29, 2009

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q**

**☐ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2009**

**○ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**Commission File Number 0-23320  
OLYMPIC STEEL, INC.**

(Exact name of registrant as specified in its charter)

Ohio

34-1245650

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification Number)

5096 Richmond Road, Bedford Heights, Ohio

44146

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code (216) 292-3800

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

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

Indicate by check mark 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. (Check one):

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

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

Indicate the number of shares of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Outstanding as of October 29, 2009
Common stock, without par value	10,883,213

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**Olympic Steel, Inc.**  
**Consolidated Balance Sheets**  
(in thousands)

	September 30, 2009 (unaudited)	December 31, 2008 (audited)
<b>Assets</b>		
Cash and cash equivalents	\$ 1,213	\$ 891
Accounts receivable, net	54,468	77,737
Inventories, net	106,879	255,300
Income taxes receivable and deferred	40,565	10,644
Prepaid expenses and other	4,954	3,908
<b>Total current assets</b>	<b>208,079</b>	<b>348,480</b>
Property and equipment, at cost	221,809	211,325
Accumulated depreciation	(106,155)	(97,820)
<b>Net property and equipment</b>	<b>115,654</b>	<b>113,505</b>
Goodwill	6,583	6,583
Other long-term assets	4,080	5,679
<b>Total assets</b>	<b>\$ 334,396</b>	<b>\$ 474,247</b>
<b>Liabilities</b>		
Accounts payable	\$ 43,130	\$ 64,883
Accrued payroll	7,316	16,403
Other accrued liabilities	7,867	13,994
<b>Total current liabilities</b>	<b>58,313</b>	<b>95,280</b>
Credit facility revolver	1,440	40,198
Other long-term liabilities	11,835	14,394
Deferred income taxes		1,417
<b>Total liabilities</b>	<b>71,588</b>	<b>151,289</b>

**Shareholders Equity**

Preferred stock

<b>Common stock</b>	<b>118,578</b>	<b>119,134</b>
<b>Retained earnings</b>	<b>144,230</b>	<b>203,824</b>
<b>Total shareholders equity</b>	<b>262,808</b>	<b>322,958</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 334,396</b>	<b>\$ 474,247</b>

*The accompanying notes are an integral part of these statements.*

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## Olympic Steel, Inc.

**Consolidated Statements of Operations**  
(in thousands, except per share and tonnage data)

	Three Months Ended September 30, 2009      2008 (unaudited)		Nine Months Ended September 30, 2009      2008 (unaudited)	
<b>Tons sold</b>				
<b>Direct</b>	161,758	237,576	470,176	837,655
<b>Toll</b>	19,670	30,090	56,622	98,849
	181,428	267,666	526,798	936,504
<b>Net sales</b>	\$ 121,599	\$ 335,222	\$ 384,898	\$ 973,611
<b>Costs and expenses</b>				
<b>Cost of materials sold (exclusive of items shown below)</b>	91,391	247,184	309,368	716,372
<b>Inventory lower of cost or market adjustments</b>			81,063	
<b>Warehouse and processing</b>	9,748	16,607	29,526	50,022
<b>Administrative and general</b>	7,855	17,524	25,183	49,875
<b>Distribution</b>	3,806	7,047	11,386	22,723
<b>Selling</b>	2,855	5,195	8,971	15,984
<b>Occupancy</b>	1,188	1,484	4,203	5,298
<b>Depreciation</b>	2,897	2,384	8,581	6,984
<b>Total costs and expenses</b>	119,740	297,425	478,281	867,258
<b>Operating income (loss)</b>	1,859	37,797	(93,383)	106,353
<b>Interest and other expense on debt</b>	567	350	1,861	537
<b>Income (loss) before income taxes</b>	1,292	37,447	(95,244)	105,816
<b>Income tax provision (benefit)</b>	621	13,280	(36,628)	38,890
<b>Net income (loss)</b>	\$ 671	\$ 24,167	\$ (58,616)	\$ 66,926
<b>Earnings per share:</b>				
<b>Net income (loss) per share    basic</b>	\$ 0.06	\$ 2.22	\$ (5.39)	\$ 6.17
<b>Weighted average shares outstanding    basic</b>	10,894	10,871	10,884	10,840
<b>Net income (loss) per share    diluted</b>	\$ 0.06	\$ 2.21	\$ (5.39)	\$ 6.13
<b>Weighted average shares outstanding    diluted</b>	10,909	10,952	10,884	10,916

*The accompanying notes are an integral part of these statements.*

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**Consolidated Statements of Cash Flows**  
**For the Nine Months Ended September 30,**  
**(in thousands)**

	2009	2008
	(unaudited)	
<b>Cash flows from (used for) operating activities:</b>		
Net income (loss)	\$ (58,616)	\$ 66,926
<b>Adjustments to reconcile net income to net cash from operating activities</b>		
Depreciation and amortization	8,941	6,984
Gain on disposition of property and equipment	(11)	(476)
Stock-based compensation	(767)	1,236
Inventory lower of cost or market adjustment	81,063	
Other long-term assets	1,239	364
Other long-term liabilities	(2,559)	4,872
Long-term deferred income taxes	(1,417)	(1,957)
	27,873	77,949
<b>Changes in working capital:</b>		
Accounts receivable	23,269	(43,383)
Inventories	67,358	(135,068)
Income taxes receivable and deferred	(29,921)	
Prepaid expenses and other	(1,046)	1,843
Accounts payable	(3,221)	32,642
Accrued payroll and other accrued liabilities	(15,191)	15,842
	41,248	(128,124)
<b>Net cash from (used for) operating activities</b>	<b>69,121</b>	<b>(50,175)</b>
<b>Cash flows from (used for) investing activities:</b>		
Capital expenditures	(10,754)	(24,391)
Proceeds from disposition of property and equipment	12	816
<b>Net cash used for investing activities</b>	<b>(10,742)</b>	<b>(23,575)</b>
<b>Cash flows from (used for) financing activities:</b>		
Credit facility revolver borrowings (payments), net	(38,758)	72,876
Change in outstanding checks	(18,532)	4,962
Proceeds from exercise of stock options (including tax benefit) and employee stock purchases	211	2,898
Dividends paid	(978)	(12,273)
<b>Net cash from (used for) financing activities</b>	<b>(58,057)</b>	<b>68,463</b>



<b>Cash and cash equivalents:</b>		
<b>Net change</b>	<b>322</b>	<b>(5,287)</b>
<b>Beginning balance</b>	<b>891</b>	<b>7,707</b>
<b>Ending balance</b>	<b>\$ 1,213</b>	<b>\$ 2,420</b>

*The accompanying notes are an integral part of these statements.*

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**Olympic Steel, Inc.**

**Notes to Consolidated Financial Statements**

**(unaudited)**

**September 30, 2009**

**(1) Basis of Presentation:**

The accompanying consolidated financial statements have been prepared from the financial records of Olympic Steel, Inc. and its wholly-owned subsidiaries (collectively Olympic or the Company), without audit and reflect all normal and recurring adjustments which are, in the opinion of management, necessary to fairly present the results of the interim periods covered by this report. Year-to-date results are not necessarily indicative of 2009 annual results and these financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2008. The Company has evaluated subsequent events for recognition or disclosure through October 29, 2009, which was the date this Form 10-Q was filed with the SEC. All significant intercompany transactions and balances have been eliminated in consolidation. Certain reclassifications of prior year amounts have been made to conform with current year presentation.

**(2) Accounts Receivable:**

The Company maintained allowances for doubtful accounts and unissued credits of \$2.7 million and \$2.4 million at September 30, 2009 and December 31, 2008, respectively. The allowance for doubtful accounts is maintained at a level considered appropriate based on historical experience and specific customer collection issues that have been identified. Estimations are based upon a calculated percentage of accounts receivable, which remains fairly level from year to year, and judgments about the probable effects of economic conditions on certain customers, which can fluctuate significantly from year to year. The Company cannot guarantee that the rate of future credit losses will be similar to past experience. The Company considers all available information when assessing the adequacy of its allowance for doubtful accounts each quarter.

**Table of Contents****(3) Inventories:**

The Company was required under GAAP to write down the value of its inventory to its net realizable value (average selling price less reasonable costs to convert the inventory into completed form), resulting in a \$30.6 million charge recorded on March 31, 2009. A second inventory lower of cost or market charge of \$50.5 million was recorded on June 30, 2009.

Steel inventories consist of the following:

(in thousands)	<b>September 30, 2009</b>	<b>December 31, 2008</b>
Unprocessed	\$ 84,777	\$ 211,246
Processed and finished	22,102	44,054
Totals	\$ 106,879	\$ 255,300

**(4) Investments in Joint Ventures:**

The Company and the United States Steel Corporation (USS) each own 50% of Olympic Laser Processing (OLP), a company that produced laser welded sheet steel blanks for the automotive industry. OLP ceased operations during the first quarter of 2006. In December 2006, the Company advanced \$3.2 million to OLP to cover a loan guarantee. As of September 30, 2009, the investment in and advance to OLP was valued at \$2.5 million on the Company's Consolidated Balance Sheet. The Company believes the underlying value of OLP's remaining real estate, upon liquidation, will be sufficient to repay the \$2.5 million advance at a later date.

**(5) Debt:**

The Company's secured bank-financing agreement (the Credit Facility) is a revolving credit facility collateralized by the Company's accounts receivable, inventories and substantially all of its property and equipment. Borrowings are limited to the lesser of a borrowing base, comprised of eligible receivables and inventories, or \$130 million in the aggregate. The Credit Facility matures on December 15, 2011.

The Credit Facility, which was last amended in July 2009, requires the Company to comply with various covenants, the most significant of which include: (i) a \$20 million reserve on availability, replaced with a minimum availability requirement of \$15 million, tested monthly, commencing

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with the month ending June 30, 2010; (ii) a minimum consolidated debt service ratio of 1.25, tested monthly, commencing with the month ended June 30, 2010; (iii) a maximum leverage ratio of 1.75, tested quarterly; (iv) commencing with the month ending April 30, 2009, consolidated EBITDA of no less than (\$5,000,000) for (a) the one month period ending April 30, 2009, (b) the two month period ending May 31, 2009, and (c) for the three month period ending June 30, 2009 and the three month period ending with each subsequent month thereafter until and including May 31, 2010; commencing with the month ending April 30, 2009 through and including the month ending May 31, 2010, a cumulative consolidated EBITDA for such period of no less than (\$10,000,000); (v) limitations on dividends, capital expenditures and investments; and (vi) restrictions on additional indebtedness. All EBITDA covenants exclude up to \$100 million of inventory lower of cost or market adjustments. As of September 30, 2009 the Company was in compliance with its covenants and had approximately \$70 million of availability under the Credit Facility.

Outstanding checks are included as part of Accounts Payable on the accompanying Consolidated Balance Sheets and such checks totaled \$1.7 million as of September 30, 2009 and \$20.3 million as of December 31, 2008.

**(6) Shares Outstanding and Earnings Per Share:**

Earnings per share have been calculated based on the weighted average number of shares outstanding as set forth below:

(in thousands, except per share data)	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Weighted average basic shares outstanding	10,894	10,871	10,884	10,840
Assumed exercise of stock options and issuance of stock awards	15	81		76
Weighted average diluted shares outstanding	10,909	10,952	10,884	10,916
Net income (loss)	\$ 671	\$ 24,167	\$ (58,616)	\$ 66,926
Basic earnings (loss) per share	\$ 0.06	\$ 2.22	\$ (5.39)	\$ 6.17
Diluted earnings (loss) per share	\$ 0.06	\$ 2.21	\$ (5.39)	\$ 6.13
Anti-dilutive securities outstanding	24		180	

**Table of Contents****(7) Stock Options:**

In January 1994, the Olympic Steel, Inc. Stock Option Plan (Option Plan) was adopted by the Board of Directors and approved by the shareholders of the Company. The Option Plan terminated on January 5, 2009. Termination of the Option Plan did not affect outstanding options.

A total of 1,300,000 shares of common stock were originally reserved for issuance under the Option Plan. To the extent possible, shares of treasury stock were used to satisfy shares resulting from the exercise of stock options. Options vested over periods ranging from six months to five years and all expire 10 years after the grant date. The following table summarizes the effect of the impact of stock options on the results of operations:

(in thousands, except per share data)	<b>For the Three Months</b>		<b>For the Nine Months Ended September</b>	
	<b>Ended September 30,</b>		<b>30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Stock option expense before taxes	\$ 53	\$ 53	\$ 158	\$ 158
Stock option expense after taxes	\$ 32	\$ 35	\$ 97	\$ 100
Impact per basic share	\$	\$	\$ 0.01	\$ 0.01
Impact per diluted share	\$	\$	\$ 0.01	\$ 0.01

All pre-tax charges related to stock options were included in the caption Administrative and general on the accompanying Consolidated Statement of Operations.

No options were granted during 2008 through the termination of the Option Plan on January 5, 2009.

The following table summarizes stock option award activity during the nine months ended September 30, 2009:

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	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Outstanding at December 31, 2008	70,007	\$ 16.75		
Granted				
Exercised	(15,000)	7.44		
Canceled				
Outstanding at September 30, 2009	55,007	\$ 19.29	5.9 years	\$ 594
Exercisable at September 30, 2009	46,950	\$ 17.00	5.4 years	\$ 594

The total intrinsic value of stock options exercised during the nine months ended September 30, 2009 and 2008 was \$227 thousand and \$4.8 million, respectively. Net cash proceeds from the exercise of stock options were \$112 thousand and \$1.1 million for the nine months ended September 30, 2009 and 2008, respectively. Income tax benefits of \$86 thousand and \$1.8 million were realized from stock option exercises during the nine months ended September 30, 2009 and 2008, respectively. The fair value of options vested during both the nine months ended September 30, 2009 and 2008 totaled \$158 thousand.

As of September 30, 2009, approximately \$113 thousand of expense, before taxes, with respect to non-vested stock option awards has yet to be recognized and will be amortized into expense over a weighted-average period of 0.52 years.

**(8) Restricted Stock Units and Performance Share Units:**

The Olympic Steel 2007 Omnibus Incentive Plan (the Plan) was approved by the Company's shareholders. The Plan authorizes the Company to grant stock options, stock appreciation rights, restricted shares, restricted share units, performance shares, and other stock- and cash-based awards to employees and Directors of, and consultants to, the Company and its affiliates. Under the Plan, 500,000 shares of common stock are available for grants.

On each of May 1, 2007, January 2, 2008 and January 2, 2009, the Compensation Committee of the Company's Board of Directors approved the grant of 1,800 restricted stock units (RSUs) to each non-employee Director. Subject to the terms of the Plan and the RSU agreement, the RSUs vest at the end of one year from the date of grant. The RSUs are not converted into shares of common stock until the Board member either resigns or is terminated from the Board of Directors.

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The Compensation Committee of the Company's Board of Directors also granted 32,378, 34,379 and 54,024 performance-earned restricted stock units (PERSUs) to the senior management of the Company on May 1, 2007, January 2, 2008 and January 2, 2009, respectively. The PERSUs may be earned based on the Company's performance for periods ranging from 32 to 36 months from the date of grant, and would be converted to shares of common stock based on the achievement of two separate financial measures: (1) the Company's EBITDA (50% weighted) and (2) return on invested capital (50% weighted). No shares will be earned unless the threshold amounts for the performance measures are met. Up to 150% of the targeted amount of PERSUs may be earned. The following table summarizes the activity related to RSUs and PERSUs for the nine months ended September 30, 2009:

	RSUs		PERSUs	
	Vested	Unvested	Vested	Unvested
Balance as of December 31, 2008	9,000	9,000		66,757
Granted		9,000		54,024
Vested	10,800	(10,800)		
Converted into shares	(5,400)			
Forfeited				(2,424)
Balance as of September 30, 2009	14,400	7,200		118,357

Stock-based compensation expense recognized on RSUs and PERSUs for the three and nine months ended September 30, 2009 and 2008, respectively, is summarized in the following table:

(in thousands, except per share data)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
Stock award expense (reversal) before taxes	\$ (479)	\$ 360	\$ (924)	\$ 1,079
Stock award expense (reversal) after taxes	\$ (288)	\$ 231	\$ (569)	\$ 682
Impact per basic share	\$(0.02)	\$0.02	\$(0.05)	\$ 0.06
Impact per diluted share	\$(0.02)	\$0.02	\$(0.05)	\$ 0.06

All pre-tax charges related to RSUs and PERSUs were included in the caption Administrative and general on the accompanying Consolidated Statement of Operations.

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**(9) Income Taxes:**

For the first nine months of 2009, the Company recorded an income tax benefit of \$36.6 million, or 38.5%. The majority of the tax benefit represents the tax effect of operating losses that can be carried back to prior years, resulting in cash refunds in 2010. The income tax receivable related to those carryback claims is included in Income taxes receivable and deferred on the accompanying Consolidated Balance Sheets.

**(10) Supplemental Cash Flow Information:**

Interest paid during the first nine months of 2009 totaled \$1.7 million, compared to \$830 thousand in the first nine months of 2008. Income taxes refunded, net of income taxes paid, during the first nine months of 2009 totaled \$2.0 million, compared to \$35.9 million of income taxes paid during the first nine months of 2008.

**(11) Impact of Recently Issued Accounting Pronouncements:**

In December 2007, the FASB issued guidance now codified as FASB ASC Topic 810, *Noncontrolling Interests in Consolidated Financial Statements – an Amendment of Accounting Research Bulletin No. 51*. This guidance requires all entities to report noncontrolling interests in subsidiaries (also known as minority interests) as a separate component of equity in the consolidated statement of financial position, to clearly identify consolidated net income attributable to the parent and to the noncontrolling interest on the face of the consolidated statement of income and to provide sufficient disclosure that clearly identifies and distinguishes between the interest of the parent and the interests of controlling owners. The new guidance under FASB ASC Topic 810 is effective as of January 1, 2009. The adoption of the new guidance under FASB ASC Topic 810 did not have any impact as the Company does not currently have any non-controlling interests in its subsidiaries.

In December 2007, the FASB issued guidance now codified as FASB ASC Topic 805, *Business Combinations*. This guidance requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed and requires the acquirer to disclose certain information related to the nature and financial effect of the business combination. The new guidance under FASB ASC Topic 805 is effective for business combinations entered into in fiscal years beginning on or after December



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15, 2008. Depending on the terms, conditions and details of the business combinations, if any, that take place subsequent to January 1, 2009, the new guidance under FASB ASC Topic 805 may have a material impact on the Company's future financial statements.

In May 2009, the FASB issued guidance now codified as FASB ASC Topic 855, *Subsequent Events*. This guidance establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The new guidance under FASB ASC Topic 855 is effective for interim or annual periods ending after June 15, 2009. The adoption of the new guidance under FASB ASC Topic 855 did not have a material impact on the Company's financial statements.

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

The following discussion and analysis should be read in conjunction with our unaudited consolidated financial statements and accompanying notes contained herein and our consolidated financial statements, accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2008. The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause a difference include, but are not limited to, those discussed under Item 1A (Risk Factors) in our Annual Report on Form 10-K. The following section is qualified in its entirety by the more detailed information, including our financial statements and the notes thereto, which appear elsewhere in this Quarterly Report on Form 10-Q.

**Overview**

We are a leading U.S. steel service center with over 55 years of experience. Our primary focus is on the direct sale and distribution of large volumes of processed carbon, coated, aluminum and stainless flat-rolled sheet, coil and plate products. We act as an intermediary between steel producers and manufacturers that require processed steel for their operations. We serve customers in most carbon steel consuming industries, including manufacturers and fabricators of transportation and material handling equipment, construction and farm machinery, storage tanks,

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environmental and energy generation, automobiles, food service and electrical equipment, military vehicles and equipment, as well as general and plate fabricators and steel service centers. We distribute our products primarily through a direct sales force.

We operate as a single business segment with 17 strategically-located processing and distribution facilities in Connecticut, Georgia, Illinois, Iowa, Michigan, Minnesota, North Carolina, Ohio, Pennsylvania and South Carolina. This geographic footprint allows us to focus on regional customers and larger national and multi-national accounts, primarily located throughout the midwestern, eastern and southern United States.

We sell a broad range of steel products, many of which have different gross profits and margins. Products that have more value-added processing generally have a greater gross profit and higher margins. Accordingly, our overall gross profit is affected by, among other things, product mix, the amount of processing performed, the demand for and availability of steel, volatility in selling prices and material purchase costs. We also perform toll processing of customer-owned steel, the majority of which is performed by our Michigan and Georgia operations. We sell certain products internationally, primarily in Puerto Rico and Mexico. All international sales and payments are made in U.S. dollars. Recent international sales have been immaterial to our consolidated financial results.

Our results of operations are affected by numerous external factors including, but not limited to: general and global business, economic, financial, banking and political conditions; competition; steel pricing and availability; energy prices; pricing and availability of raw materials used in the production of steel; inventory held in the supply chain; customer demand for steel; customers' ability to manage their credit line availability; and layoffs or work stoppages by our own, our suppliers or our customers' personnel. The steel industry also continues to be affected by the global consolidation of our suppliers, competitors and end-use customers.

Like many other steel service centers, we maintain substantial inventories of steel to accommodate the short lead times and just-in-time delivery requirements of our customers. Accordingly, we purchase steel in an effort to maintain our inventory at levels that we believe to be appropriate to satisfy the anticipated needs of our customers based upon customer forecasts, historic buying practices, supply agreements with customers and market conditions. Our commitments to purchase steel are generally at prevailing market prices in effect at the time we place our orders. We have no long-term, fixed-price steel purchase contracts. When steel prices increase, competitive conditions will influence how much of the price increase we can pass on to

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our customers. To the extent we are unable to pass on future price increases in our raw materials to our customers, the net sales and profitability of our business could be adversely affected. When steel prices decline, as they did from the fourth quarter of 2008 through the second quarter of 2009, customer demands for lower prices and our competitors responses to those demands could result in lower sales prices and, consequently, lower margins as we use existing steel inventory.

As selling prices declined in 2009, our average selling prices fell below our average cost of inventory requiring us to recognize inventory lower of cost or market adjustments. We were required under GAAP to write down the value of our inventory to its net realizable value, less reasonable costs to complete the inventory into finished form, resulting in a \$30.6 million pre-tax charge at the end of the first quarter of 2009. Selling prices continued to decline during the second quarter of 2009, resulting in an additional \$50.5 million inventory lower of cost or market pre-tax charge effective as of June 30, 2009.

Due to the ongoing global economic crisis and the unprecedented drop in sales, we have taken significant steps to reduce our operating expenses. We estimate that we have reduced our annual operating expenses for 2009 by approximately \$70 million, or 37%, compared to our total annual 2008 operating expenses. The cost reductions have been achieved through various initiatives, including: headcount reductions of 21% from peak 2008 levels; elimination of temporary labor and overtime; reduced work hours to match depressed customer production schedules; company-wide base pay reductions ranging from 2.5% to 10%, including cash compensation reductions taken by our executive management team equal to 20% of each executives base salary; a 20% cash compensation reduction of our Board of Directors fees; the consolidation of our Philadelphia facility into our other Pennsylvania facilities; benefits reductions; and heightened control over all discretionary spending.

At September 30, 2009, we employed approximately 991 people; however, due to the ongoing global economic crisis, some of those employees were temporarily laid-off and many of our hourly employees worked less than 40 hours per week. Approximately 144 of the hourly plant personnel at our Minneapolis and Detroit facilities are represented by three separate collective bargaining units. A collective bargaining agreement covering our Detroit workers was extended through August 31, 2012. A collective bargaining agreement covering our Minneapolis plate facility workers was extended to March 31, 2012. A collective bargaining agreement covering our Minneapolis coil facility employees expires on September 30, 2010. We have never

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experienced a work stoppage and we believe that our relationship with employees is good. However, any prolonged work stoppages by our personnel represented by collective bargaining units could have a material adverse impact on our business, financial condition, results of operations and cash flows.

**Critical Accounting Policies**

This discussion and analysis of financial condition and results of operations is based on our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from these estimates under different assumptions or conditions. On an ongoing basis, we monitor and evaluate our estimates and assumptions.

For further information regarding the accounting policies that we believe to be critical accounting policies and that affect our more significant judgments and estimates used in preparing our consolidated financial statements, see Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2008.

**Table of Contents****Results of Operations**

The following table sets forth certain income statement data for the three and nine months ended September 30, 2009 and 2008 (dollars are shown in thousands):

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2009		2008		2009		2008	
	\$	% of net sales	\$	% of net sales	\$	% of net sales	\$	% of net sales
Net sales	\$ 121,599	100.0%	\$ 335,222	100.0%	\$ 384,898	100.0%	\$ 973,611	100.0%
Gross profit before lower of cost or market adjustment (1)	30,208	24.8%	88,038	26.3%	75,530	19.6%	257,239	26.4%
Gross profit (loss) after lower of cost or market adjustment	30,208	24.8%	88,038	26.3%	(5,533)	(1.4%)	257,239	26.4%
Operating expenses (2)	28,349	23.3%	50,241	15.0%	87,850	22.8%	150,886	15.5%
Operating income (loss)	\$ 1,859	1.5%	\$ 37,797	11.3%	\$ (93,383)	(24.3%)	\$ 106,353	10.9%

(1) Gross profit is calculated as net sales less the cost of materials sold and excludes the inventory lower of cost or market adjustment. This calculation is presented in order to provide greater comparability to prior period results.

(2) Operating expenses are calculated as total costs and

expenses less  
the cost of  
materials sold  
and the  
inventory lower  
of cost or  
market  
adjustment.

Tons sold decreased 32.2% to 181 thousand in the third quarter of 2009 from 268 thousand in the third quarter of 2008. Tons sold in the third quarter of 2009 included 162 thousand from direct sales and 19 thousand from toll processing, compared with 238 thousand direct tons and 30 thousand toll tons in the comparable period of last year. Tons sold decreased 43.7% to 527 thousand in the first nine months of 2009 from 937 thousand in the first nine months of 2008. Tons sold in the first nine months of 2009 included 470 thousand direct tons and 57 thousand from toll processing, compared with 838 thousand direct tons and 99 thousand toll tons in the comparable period last year. Tons sold in the third quarter and first nine months of 2009 were significantly lower to all markets we sell, compared to comparable 2008 periods, due to recessionary pressures and unprecedented crises in global financial markets. Many of our large original equipment manufacturers had numerous plant closings and significant reductions in their production schedules during the first nine months of 2009, which are expected to continue in the fourth quarter of 2009. Although we experienced stronger sales volumes in the third quarter of 2009 when compared to the second quarter of 2009, we believe that seasonally slower production patterns, combined with the current global economic situation, may lead to fourth quarter sales volumes that are slightly lower than those experienced during the third quarter of 2009.

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Net sales decreased 63.7% to \$121.6 million in the third quarter of 2009 from \$335.2 million in the third quarter of 2008. Net sales decreased 60.5% to \$384.9 million in the first nine months of 2009 from \$973.6 million in the first nine months of 2008. The decreases in sales were primarily attributable to lower sales volumes and a decline in average selling prices due to recessionary pressures, the ongoing global economic crisis, the liquidation of inventory at steel service centers and less value-added sales. Average selling prices in the third quarter of 2009 were \$670 per ton, compared with \$1,252 per ton in the third quarter of 2008, and \$704 per ton in the second quarter of 2009. Average selling prices continued to decline through August 2009 and began to increase in September 2009. We believe that our average selling prices in the beginning of the fourth quarter of 2009 will be higher than those experienced during the third quarter of 2009. However, we anticipate that reduced demand in the later half of the fourth quarter of 2009, caused by normal seasonal patterns, could lead to reduced selling prices at the end of the fourth quarter of 2009.

As a percentage of net sales, gross profit, before the inventory lower of cost or market adjustment, decreased to 24.8% in the third quarter of 2009 from 26.3% in the third quarter of 2008. For the first nine months of 2009, gross margins (excluding the inventory lower of cost or market adjustment) decreased to 19.6% from 26.4% in the first nine months of 2008. The price of steel purchased from steel producers began to rapidly decrease in late third quarter of 2008. At the same time, customer demand began to decrease significantly due to the ongoing global economic crisis, which resulted in lower overall selling prices. This condition continued during the fourth quarter of 2008 and first half of 2009. Our average cost of goods sold, as a percentage of sales and excluding inventory lower of cost or market adjustments, increased during these periods as we sold steel we acquired on earlier dates at higher prices. The higher cost of goods sold, combined with lower selling prices, resulted in decreased gross margins.

As selling prices further declined in the first half of 2009, our average selling prices fell below our average cost of inventory resulting in inventory lower of cost or market adjustments. We were required to write down the value of our inventory to its net realizable value (average selling price less reasonable costs to complete the inventory into finished form), resulting in a \$30.6 million pre-tax charge at the end of the first quarter of 2009. Selling prices continued to decline during the second quarter of 2009, resulting in an additional \$50.5 million inventory lower of cost or market pre-tax adjustment at June 30, 2009. Announced steel price increases from steel producers in the third quarter of 2009, combined with lower-costed inventory (due to the lower

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of cost or market adjustment) and newly purchased inventory, resulted in improving gross margin levels during the later part of the third quarter of 2009. We expect gross margins in the beginning of the fourth quarter of 2009 to be stronger than those experienced during the third quarter of 2009. However, we anticipate that reduced demand in the later half of the fourth quarter of 2009, caused by normal seasonal patterns, could lead to reduced selling prices and reduced gross margins at the end of the fourth quarter of 2009.

Operating expenses in the third quarter of 2009 decreased \$21.9 million from the third quarter of 2008. Operating expenses in the first nine months of 2009 decreased \$63.0 million from the first nine months of 2008. Lower operating expenses in 2009 were primarily attributable to decreased levels of variable incentive compensation associated with lower levels of profitability (the majority of which was recorded in general and administrative operating expense captions, with a portion also recorded in the warehouse and processing and selling expense captions), decreased distribution expense resulting from reduced shipping levels (recorded in the distribution expense caption) and decreased warehouse and processing expense associated with lower shipping levels.

Due to the ongoing global economic crisis and the unprecedented drop in sales, we have taken significant steps to reduce our operating expenses. We estimate that we have reduced our annual operating expenses for 2009 by approximately \$70 million, or 37%, compared to our total annual 2008 operating expenses. The cost reductions have been achieved through various initiatives, including headcount reductions of 24% from peak 2008 levels, elimination of temporary labor and overtime, reduced work hours to match depressed customer production schedules, company-wide base pay reductions ranging from 2.5% to 10%, including cash compensation reductions taken by our executive management team equal to 20% of each executive's base salary, a 20% cash compensation reduction of our Board of Directors' fees, the consolidation of our Philadelphia operations into our other Pennsylvania facilities, benefits reductions and heightened control over all discretionary spending. Continued decline in customer demand may require us to take further expense reduction actions. Customer bankruptcies could lead to higher bad debt expense in the future.

Interest and other expense on debt totaled \$567 thousand for the third quarter of 2009 compared to \$350 thousand for the third quarter of 2008. Interest and other expense on debt totaled \$1.9 million for the first nine months of 2009, compared to \$537 thousand for the first nine months of 2008. Our effective borrowing rate, exclusive of deferred financing fees and commitment fees, was 3.7% for the first nine months of 2009 compared to 4.0% for the first nine months of 2008.



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The increase in 2009 interest and other expense on debt was primarily attributable to higher overall borrowing levels, higher amortization of financing fees related the 2009 amendments of our credit facility and lower amounts of interest capitalized into long-term projects. In April and July 2009, as a result of deteriorating market conditions and our inventory lower of cost or market adjustment, we obtained a bank amendments to modify certain financial covenants on our revolving credit facility. As part of the amendments, our average cost of borrowings has increased to approximately 5% to 6%.

For the third quarter of 2009, income before income taxes totaled \$1.3 million compared to \$37.4 million in the third quarter of 2008. For the first nine months of 2009, loss before income taxes totaled \$95.2 million, compared to income of \$105.8 million in the first nine months of 2008. An income tax benefit of 38.5% was recorded for the first nine months of 2009, compared to a tax provision of 36.8% for the first nine months of 2008. The majority of the 2009 losses can be carried back to prior years, resulting in future income tax refunds to be received in 2010. Income taxes refunded, net of income taxes paid, during the first nine months of 2009 totaled \$2.0 million, compared to \$35.9 million of income taxes paid during the first nine months of 2008.

Net income for the third quarter of 2009 totaled \$0.7 million or \$0.06 per basic and diluted share, compared to \$24.2 million or \$2.21 per diluted share for the third quarter of 2008. Net loss for the first nine months of 2009 totaled \$58.6 million or \$5.39 per basic and diluted share, compared to net income of \$66.9 million or \$6.13 per diluted share for the first nine months of 2008.

**Liquidity and Capital Resources**

Our principal capital requirements include funding working capital needs, purchasing, upgrading and acquiring processing equipment, facilities and other businesses and paying dividends. We use cash generated from operations, leasing transactions and our revolving credit facility to fund these requirements.

Working capital at September 30, 2009 totaled \$149.8 million, a \$103.4 million decrease from December 31, 2008.

The decrease was primarily attributable to a \$23.3 million reduction in accounts receivable (resulting from lower sales volumes and sales prices) and a \$148.4 million reduction in inventories (inclusive of inventory lower of cost or market adjustments), partially offset by a \$29.9 million increase in income taxes receivable and deferred, a \$21.8 million reduction in accounts payable (associated with lower steel prices and reduced steel purchases)

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and a \$15.2 million reduction in accrued expenses (primarily associated with lower incentive compensation). For the nine months ended September 30, 2009, we generated \$69.1 million of net cash from operations, of which \$27.9 million was related to earnings from operating activities and \$41.2 million was generated from working capital. During the first nine months of 2009, we spent \$10.8 million on capital expenditures. The expenditures were primarily attributable to the completion of projects that were started during the second half of 2008, including the expansion of our Chambersburg, Pennsylvania facility, the completion of a new office building in Winder, Georgia, site work related to a suspended project in South Carolina and continued investments associated with our new business system. During the remainder of 2009, we expect to spend approximately \$2 million on our new business system implementation and maintenance-type capital expenditures.

We continue to successfully implement our new business system. During the first nine months of 2009, we expensed \$1.7 million and capitalized \$1.9 million associated with the implementation of the new information system. Since the project began in 2006, we have expensed \$7.9 million and capitalized \$11.1 million associated with the new information system.

During the first nine months of 2009, we used \$58.1 million for financing activities, which primarily consisted of \$38.8 million of repayments under our revolving credit facility and an \$18.5 million decrease in outstanding checks. In October 2009, our Board of Directors approved a regular quarterly dividend of \$0.02 per share, which is payable on December 15, 2009 to shareholders of record as of December 1, 2009. Our Board previously approved 2009 regular quarterly dividends of \$0.05, \$0.02 and \$0.02 per share, which were paid on March 16, 2009, June 15, 2009 and September 15, 2009, respectively. Regular dividend distributions in the future are subject to the availability of cash, the \$2.25 million annual limitation on cash dividends under our revolving credit facility, and continuing determination by our Board of Directors that the payment of dividends remains in the best interest of our shareholders. Our secured bank-financing agreement is a revolving credit facility collateralized by our accounts receivable, inventories and substantially all of our property and equipment. Borrowings

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are limited to the lesser of a borrowing base, comprised of eligible receivables and inventories, or \$130 million in the aggregate. The credit facility matures on December 15, 2011.

The credit facility, which was last amended in July 2009, requires us to comply with various covenants, the most significant of which include: (i) a \$20 million reserve on availability, replaced with a minimum availability requirement of \$15 million, tested monthly, commencing with the month ending June 30, 2010; (ii) a minimum consolidated debt service ratio of 1.25, tested monthly, commencing with the month ended June 30, 2010; (iii) a maximum leverage ratio of 1.75, tested quarterly; (iv) commencing with the month ending April 30, 2009, consolidated EBITDA of no less than (\$5,000,000) for (a) the one month period ending April 30, 2009, (b) the two month period ending May 31, 2009, and (c) for the three month period ending June 30, 2009 and the three month period ending with each subsequent month thereafter until and including May 31, 2010; commencing with the month ending April 30, 2009 through and including the month ending May 31, 2010, a cumulative consolidated EBITDA for such period of no less than (\$10,000,000); (v) limitations on dividends, capital expenditures and investments; and (vi) restrictions on additional indebtedness. All EBITDA covenants exclude up to \$100 million of inventory lower of cost or market adjustments. As of September 30, 2009 we reduced our outstanding debt to \$1.4 million, we were in compliance with our covenants and we had approximately \$70 million of availability under the credit facility. We believe that funds available under our credit facility and lease arrangement proceeds, together with funds generated from operations and future tax refunds, will be sufficient to provide us with the liquidity necessary to fund anticipated working capital requirements, capital expenditure requirements, our dividend payments and any business acquisitions over at least the next 12 months. However, further deterioration of market conditions in 2009 could result in decreased availability and adversely impact our ability to remain in compliance with covenants under our credit facility. In the future, we may, as part of our business strategy, acquire and dispose of other companies in the same or complementary lines of business, or enter into and exit strategic alliances and joint ventures. Accordingly, the timing and size of our capital requirements are subject to change as business conditions warrant and opportunities arise.

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**Forward-Looking Information**

This Quarterly Report on Form 10-Q and other documents we file with the SEC contain various forward-looking statements that are based on current expectations, estimates, forecasts and projections about our future performance, business, our beliefs and management's assumptions. In addition, we, or others on our behalf, may make forward-looking statements in press releases or written statements, or in our communications and discussions with investors and analysts in the normal course of business through meetings, conferences, webcasts, phone calls and conference calls. Words such as may, will, anticipate, should, intend, expect, believe, estimate, and continue, as well as the negative of these terms or similar expressions, are intended to identify forward-looking statements, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those implied by such statements including, but not limited to those set forth in Item 1A (Risk Factors), as found in our Annual Report on Form 10-K for the year ended December 31, 2008, and the following:

further deterioration of steel demand and steel pricing;

general and global business, economic, financial and political conditions, including the ongoing effects of the global credit crisis;

access to capital and global credit markets;

competitive factors such as availability and pricing of steel, industry shipping and inventory levels and rapid fluctuations in customer demand and steel pricing;

the cyclical and volatility within the steel industry;

the ability of customers (especially those that may be highly leveraged, those in the domestic automotive industry and those with inadequate liquidity) to maintain their credit availability;

customer, supplier, and competitor consolidation, bankruptcy or insolvency, especially those in the domestic automotive industry;

reduced production schedules, layoffs or work stoppages by our own or our suppliers' or customers' personnel;

the availability and costs of transportation and logistical services;

equipment installation delays or malfunctions;

the amounts, successes and our ability to continue our capital investments and our business information system project;

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the successes of our strategic efforts and initiatives to increase sales volumes, maintain or improve working capital turnover and free cash flows, reduce costs, inventory and debt in a declining market, while improving customer service;

the timing and outcome of inventory lower of cost or market adjustments;

the adequacy of our existing information technology and business system software;

the successful implementation of our new enterprise-wide information system;

the timing and outcome of OLP's efforts and ability to liquidate its remaining assets;

our ability to pay regular quarterly cash dividends and the amounts and timing of any future dividends; and

our ability to generate free cash flow through operations, reduce inventory and to repay debt within anticipated timeframes.

Should one or more of these or other risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, intended expected, believed, estimated, projected or planned. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to republish revised forward-looking statements to reflect the occurrence of unanticipated events or circumstances after the date hereof, except as otherwise required by law.

**Item 3. *Qualitative and Quantitative Disclosures About Market Risk***

During the past several years, the base price of carbon flat-rolled steel has fluctuated significantly and rapidly. We witnessed unprecedented steel producer price increases during the first nine months of 2008 followed by rapid and steep steel price declines during the fourth quarter of 2008 and first half of 2009. Rapidly declining prices, as we experienced during the first six months of 2009, reduced our gross profit margin percentages to levels that are lower than our historical levels. Higher inventory levels held by us, other steel service centers, or end-use customers could cause competitive pressures that could also reduce gross profit. Higher raw material costs for steel producers could cause the price of steel to increase. Rising prices result in higher working capital requirements for us and our customers. Some customers may not have sufficient credit lines or liquidity to absorb significant increases in the price of steel. While we have generally been successful in the past in passing on producers' price increases and surcharges to our customers, there is no guarantee that we will be able to pass on price increases to our customers in the future.

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Approximately 10.8% of our net sales in the first nine months of 2009 were directly to automotive manufacturers or manufacturers of automotive components and parts. The automotive industry experiences significant fluctuations in demand based on numerous factors such as general economic conditions and consumer confidence. The automotive industry is also subject, from time to time, to labor work stoppages. The domestic automotive industry, which has experienced a number of bankruptcies, is currently involved in significant restructuring, which has resulted in lower 2009 production volumes. Certain customers in this industry represent an increasing credit risk.

Inflation generally affects us by increasing the cost of employee wages and benefits, transportation services, processing equipment, energy and borrowings under our credit facility. General inflation, excluding increases in the price of steel and increased distribution expense, has not had a material effect on our financial results during the past two years.

When raw material prices increase, competitive conditions will influence how much of the steel price increase can be passed on to our customers. When raw material prices decline, customer demands for lower cost product result in lower selling prices. Declining steel prices, as we experienced in the fourth quarter of 2008 and first half of 2009, have generally adversely affected our net sales and net income, while increasing steel prices, as we experienced during the third quarter of 2009, generally favorably affect net sales and net income.

We are exposed to the impact of interest rate changes and fluctuating steel prices. We have not entered into any interest rate or steel commodity hedge transactions for speculative purposes or otherwise.

Our primary interest rate risk exposure results from variable rate debt. We currently do not hedge our exposure to variable interest rate risk. However, we do have the option to enter into 30- to 180-day fixed base rate Euro loans under our credit facility.

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**Item 4. *Controls and Procedures***

The evaluation required by Rule 13a-15 of the Securities Exchange Act of 1934 of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report has been carried out under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. These disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in reports that are filed with or submitted to the SEC is: (i) accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures and (ii) recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2009, our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting that occurred during the third quarter of 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**Part II. OTHER INFORMATION**

Items 1, 1A, 2, 3, 4 and 5 of this Part II are either inapplicable or are answered in the negative and are omitted pursuant to the instructions to Part II.

**Item 6. Exhibits**

<b>Exhibit</b>	<b>Description of Document</b>	<b>Reference</b>
31.1	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith
31.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith
32.1	Certification of the Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Furnished herewith
32.2	Certification of the Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Furnished herewith



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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.

**OLYMPIC STEEL, INC.**  
(Registrant)

Date: October 29, 2009

By: /s/ Michael D. Siegal

**Michael D. Siegal**  
Chairman of the Board and Chief Executive Officer

By: /s/ Richard T. Marabito

**Richard T. Marabito**  
Chief Financial Officer  
(Principal Financial and Accounting Officer)  
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