OLYMPIC STEEL INC
Form 10-Q
April 29, 2010

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

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

**For the quarterly period ended March 31, 2010**

o **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 þ No o

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 o No o

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 o | Accelerated filer þ | Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |

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

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 April 29, 2010 |
|---|---|
| Common stock, without par value | 10,883,411 |

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**Part I. FINANCIAL INFORMATION**
**Item 1.** ***Financial Statements***

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

| | March 31, 2010 (unaudited) | December 31, 2009 (audited) |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | $ 1,008 | $ 5,190 |
| Accounts receivable, net | 81,940 | 51,269 |
| Inventories, net | 129,274 | 111,663 |
| Income taxes receivable and deferred | 41,489 | 41,963 |
| Prepaid expenses and other | 4,532 | 4,686 |
| Total current assets | 258,243 | 214,771 |
| Property and equipment, at cost | 224,311 | 222,149 |
| Accumulated depreciation | (111,755) | (108,589) |
| Net property and equipment | 112,556 | 113,560 |
| Goodwill | 7,083 | 6,583 |
| Other long-term assets | 3,917 | 3,534 |
| Total assets | $ 381,799 | $ 338,448 |
| **Liabilities** | | |
| Accounts payable | $ 71,140 | $ 52,167 |
| Accrued payroll | 10,151 | 6,874 |
| Other accrued liabilities | 7,883 | 7,213 |
| Total current liabilities | 89,174 | 66,254 |
| Credit facility revolver | 23,420 | |
| Other long-term liabilities | 6,610 | 11,949 |
| Deferred income taxes | 1,293 | 633 |
| Total liabilities | 120,497 | 78,836 |
| **Shareholders Equity** | | |
| Preferred stock | | |

| | | |
|---|---|---|
| **Common stock** | **118,408** | **118,212** |
| **Retained earnings** | **142,894** | **141,400** |
| **Total shareholders equity** | **261,302** | **259,612** |
| **Total liabilities and shareholders equity** | **$ 381,799** | **$ 338,448** |

***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 March 31, 2010 | 2009 |
|---|---|---|
| | (unaudited) | |
| **Tons sold** | | |
| Direct | 201,025 | 151,273 |
| Toll | 20,465 | 20,167 |
| | 221,490 | 171,440 |
| Net sales | $ 167,901 | $ 140,873 |
| **Costs and expenses** | | |
| Cost of materials sold (excludes items shown separately below, includes $30,609 of inventory lower of cost or market adjustments in 2009) | 132,536 | 150,925 |
| Warehouse and processing | 10,572 | 10,342 |
| Administrative and general | 8,885 | 9,945 |
| Distribution | 4,057 | 3,674 |
| Selling | 3,877 | 3,522 |
| Occupancy | 1,399 | 1,716 |
| Depreciation | 3,246 | 2,719 |
| Total costs and expenses | 164,572 | 182,843 |
| Operating income (loss) | 3,329 | (41,970) |
| Interest and other expense on debt | 506 | 243 |
| Income (loss) before income taxes | 2,823 | (42,213) |
| Income tax provision (benefit) | 1,112 | (16,758) |
| Net income (loss) | $ 1,711 | $ (25,455) |
| **Earnings per share:** | | |
| Net income (loss) per share basic | $ 0.16 | $ (2.34) |
| Weighted average shares outstanding basic | 10,905 | 10,880 |
| Net income (loss) per share diluted | $ 0.16 | $ (2.34) |
| Weighted average shares outstanding diluted | 10,918 | 10,880 |

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

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**Olympic Steel, Inc.**
**Consolidated Statements of Cash Flows**
**For the Three Months Ended March 31,**
**(in thousands)**

| | 2010 | 2009 |
|---|---|---|
| | (unaudited) | |
| **Cash flows from (used for) operating activities:** | | |
| Net income (loss) | $ 1,711 | $ (25,455) |
| Adjustments to reconcile net income (loss) to net cash from operating activities - | | |
| Depreciation and amortization | 3,454 | 2,719 |
| (Gain) loss on disposition of property and equipment | 16 | |
| Stock-based compensation | 184 | 446 |
| Other long-term assets | (1,091) | (6,724) |
| Other long-term liabilities | (5,339) | (3,326) |
| Long-term deferred income taxes | 660 | (1,417) |
| | (405) | (33,757) |
| **Changes in working capital:** | | |
| Accounts receivable | (30,671) | 15,273 |
| Inventories | (17,611) | 29,220 |
| Income taxes receivable and deferred | 474 | |
| Prepaid expenses and other | 154 | (15,052) |
| Accounts payable | 19,609 | (14,129) |
| Accrued payroll and other accrued liabilities | 3,948 | (9,312) |
| | (24,097) | 6,000 |
| Net cash used for operating activities | (24,502) | (27,757) |
| **Cash flows from (used for) investing activities:** | | |
| Capital expenditures | (2,262) | (7,180) |
| Proceeds from disposition of property and equipment | 4 | |
| Net cash used for investing activities | (2,258) | (7,180) |
| **Cash flows from (used for) financing activities:** | | |
| Credit facility revolver borrowings (payments), net | 23,420 | 48,945 |
| Change in outstanding checks | (636) | (13,089) |
| Proceeds from exercise of stock options (including tax benefit) and employee stock purchases | 12 | |
| Dividends paid | (218) | (543) |
| Net cash from financing activities | 22,578 | 35,313 |

| | | |
|---|---|---|
| **Cash and cash equivalents:** | | |
| **Net change** | **(4,182)** | **376** |
| **Beginning balance** | **5,190** | **891** |
| **Ending balance** | **$ 1,008** | **$ 1,267** |

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

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**Olympic Steel, Inc.**
**Notes to Consolidated Financial Statements**
**(unaudited)**
**March 31, 2010**

**(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 state the results of the interim periods covered by this report. Year-to-date results are not necessarily indicative of 2010 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, 2009. All significant intercompany transactions and balances have been eliminated in consolidation.

**(2) Accounts Receivable:**

The Company maintained allowances for doubtful accounts and unissued credits of $1.8 million and $2.1 million at March 31, 2010 and December 31, 2009, 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.

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**(3) Inventories:**
Steel inventories consist of the following:

| (in thousands) | March 31, 2010 | December 31, 2009 |
|---|---|---|
| Unprocessed | $ 96,468 | $ 86,071 |
| Processed and finished | 32,806 | 25,592 |
| Totals | $ 129,274 | $ 111,663 |

In 2009 the Company was required under generally accepted accounting principles 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.

**(4) Investments in Joint Ventures:**
The Company and the United States Steel Corporation 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 March 31, 2010, 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

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) consolidated EBITDA of no less than ($5,000,000) for each three month period 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 March 31, 2010, the Company was in compliance with its covenants and had approximately $74 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 $9.6 million as of March 31, 2010 and $10.2 million as of December 31, 2009.

**(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) | For the Three Months Ended March 31, 2010 | 2009 |
|---|---|---|
| Weighted average basic shares outstanding | 10,905 | 10,880 |
| Assumed exercise of stock options and issuance of stock awards | 13 | |
| Weighted average diluted shares outstanding | 10,918 | 10,880 |
| Net income (loss) | $ 1,711 | $ (25,455) |
| Basic earnings (loss) per share | $ 0.16 | $ (2.34) |
| Diluted earnings (loss) per share | $ 0.16 | $ (2.34) |
| Anti-dilutive securities outstanding | 143 | 198 |

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**(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:

| | For the Three Months Ended March 31, | |
|---|---|---|
| (in thousands, except per share data) | **2010** | **2009** |
| Stock option expense before taxes | $ 43 | $ 53 |
| Stock option expense after taxes | $ 26 | $ 32 |
| Impact per basic share | $ | $ |
| Impact per diluted share | $ | $ |

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 three months ended March 31, 2010:

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| | Number of Options | Weighted Average Exercise Price | | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (in thousands) | |
|---|---|---|---|---|---|---|
| Outstanding at December 31, 2009 | 55,007 | $ | 19.29 | | | |
| Granted | | | | | | |
| Exercised | | | | | | |
| Canceled | | | | | | |
| Outstanding at March 31, 2010 | 55,007 | $ | 19.29 | 5.2 years | $ | 715 |
| Exercisable at March 31, 2010 | 46,950 | $ | 17.00 | 4.9 years | $ | 715 |

There were no stock options exercised during the three months ended March 31, 2010 and 2009. The fair value of options vested during the three months ended March 31, 2010 and 2009 totaled $43 thousand and $53 thousand, respectively.

As of March 31, 2010, approximately $18 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 0.08 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 in 2007. 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 equity grants.

On each of January 2, 2008, January 2, 2009 and January 4, 2010, 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 after one year of service (from the date of grant). The RSUs are not converted into shares of common stock until the director either resigns or is terminated from the Board of Directors.

On January 4, 2010, the Compensation Committee of the Company s Board of Directors approved the grant of 23,202 RSUs to the senior management of the Company. Subject to the terms of the Plan and the RSU agreement, the RSUs vest at the end of three years from the date of grant.

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The Compensation Committee of the Company s Board of Directors also granted 34,379 and 54,024 performance-earned restricted stock units (PERSUs) to the senior management of the Company on January 2, 2008 and January 2, 2009, respectively. The PERSUs may be earned based on the Company s performance for a period of 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 fair value of each RSU and PERSU was estimated to be the closing price of the Company s common stock on the date of the grant, which was $33.85, $21.68 and $32.20 for the grants on January 4, 2010, January 2, 2009 and January 2, 2008, respectively.

Stock-based compensation expense recognized on RSUs and PERSUs for the three months ended March 31, 2010 and 2009, respectively, is summarized in the following table:

| | **For the Three Months Ended March 31,** | |
|---|---|---|
| (in thousands, except per share data) | **2010** | **2009** |
| Stock award expense before taxes | $ 142 | $ 433 |
| Stock award expense after taxes | $ 86 | $ 261 |
| Impact per basic share | $0.01 | $0.02 |
| Impact per diluted share | $0.01 | $0.02 |

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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The following table summarizes the activity related to RSUs for the three months ended March 31, 2010:

| | Number of Shares | Weighted Average Exercise Price | | Aggregate Intrinsic Value | |
|---|---|---|---|---|---|
| Outstanding at December 31, 2009 | 21,600 | $ | 28.84 | | |
| Granted | 32,202 | $ | 33.85 | | |
| Converted into shares | | $ | | | |
| Forfeited | | $ | | | |
| Outstanding at March 31, 2010 | 53,802 | $ | 31.84 | $ | 75 |
| Vested at March 31, 2010 | 21,600 | $ | 28.84 | $ | 75 |

There was no intrinsic value for the RSUs that were converted into shares in 2009. No RSUs were converted into shares in 2010.
The following table summarizes the activity related to PERSUs for the three months ended March 31, 2010:

| | Number of Shares | Weighted Average Exercise Price | | Aggregate Intrinsic Value | |
|---|---|---|---|---|---|
| Outstanding at December 31, 2009 | 86,668 | $ | 25.77 | | |
| Granted | | $ | | | |
| Converted into shares | | $ | | | |
| Lapsed based on performance criteria | | $ | | | |
| Forfeited | | $ | | | |
| Outstanding at March 31, 2010 | 86,668 | $ | 25.77 | $ | 548 |
| Vested at March 31, 2010 | | $ | | $ | |

Since inception of the PERSU program, no PERSUs have been converted into shares.

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**(9) Income Taxes:**

For the first three months of 2010, the Company recorded an income tax provision of $1.1 million, or 39.4%, compared to an income tax benefit of $16.8 million, or 39.7%, for the first three months of 2009. The majority of the tax benefit from 2009 represents the tax effect of operating losses that were carried back to prior years, resulting in cash refund of $38.2 million received in April 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 three months of 2010 totaled $169 thousand, compared to $421 thousand in the first three months of 2009. Income taxes refunded during the first three months of 2010 and 2009, respectively, totaled $7 thousand and $14 thousand.

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

There were no accounting pronouncements issued in the first quarter of 2010 expected to have a future material impact on Olympic Steel 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, 2009. 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 for the year ended December 31, 2009. 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.

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**Overview**

We are a leading U.S. steel service center with over 56 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, 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 16 strategically-located processing and distribution facilities in Connecticut, Georgia, Illinois, Iowa, Michigan, Minnesota, North Carolina, Ohio, Pennsylvania, South Carolina and Washington. 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. 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, demand 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.

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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 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, customer demands for lower prices and our competitors responses to those demands could result in lower sale 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 generally accepted accounting principles 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 during 2009, we took significant steps to reduce our operating expenses. The cost reductions were achieved through various initiatives, including: headcount reductions; elimination of temporary labor and overtime; reduced work hours to match depressed customer production schedules; company-wide base pay reductions; the consolidation of our Philadelphia facility into our other facilities; benefits reductions; and heightened control over all discretionary spending.