OLYMPIC STEEL INC
Form 10-Q
November 07, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2011

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

For the transition period from to

Commission File Number 0-23320

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

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 November 4, 2011
Common stock, without par value	10,905,115

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Olympic Steel, Inc.

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Part I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

Olympic Steel, Inc.

Consolidated Balance Sheets

(in thousands)

	September 30, 2011 (unaudited)	December 31, 2010 (audited)
Assets		
Cash and cash equivalents	$ 1,211	$ 1,492
Accounts receivable, net	154,588	82,859
Inventories, net	293,585	200,606
Prepaid expenses and other	12,526	13,852
Assets held for sale	1,268	
Total current assets	463,178	298,809
Property and equipment, at cost	314,288	239,500
Accumulated depreciation	(131,520)	(121,266)
Net property and equipment	182,768	118,234
Goodwill	46,056	7,083
Intangible assets, net	36,535	
Other long-term assets	10,474	5,312
Total assets	$ 739,011	$ 429,438
Liabilities		
Current portion of long-term debt	$ 9,661	$
Accounts payable	135,578	81,645
Accrued payroll	10,915	11,214
Other accrued liabilities	15,982	9,766
Total current liabilities	172,136	102,625
Credit facility revolver	174,460	55,235
Long-term debt	65,634	
Other long-term liabilities	10,053	4,807
Deferred income taxes	30,654	5,133
Total liabilities	452,937	167,800
Stockholders Equity		
Preferred stock		
Common stock	119,657	118,976
Accumulated other comprehensive income	4	
Retained earnings	166,413	142,662

Total shareholders equity		286,074		261,638
Total liabilities and shareholders equity	$	739,011	$	429,438

The accompanying notes are an integral part of these statements.

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Olympic Steel, Inc.

Consolidated Statement of Operations

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
	(unaudited)		(unaudited)	
Net sales	$ 348,547	$ 209,185	$ 941,928	$ 589,842
Costs and expenses				
Cost of materials sold (excludes items shown seperately below)	281,058	171,730	750,638	473,676
Warehouse and processing	19,471	13,436	51,432	37,057
Administrative and general	16,461	9,388	43,339	28,600
Distribution	8,080	5,176	20,427	14,312
Selling	7,209	6,164	18,140	14,845
Occupancy	2,297	1,297	5,790	3,940
Depreciation	4,434	3,270	11,413	9,775
Amortization	222		222	
Total costs and expenses	339,232	210,461	901,401	582,205
Operating income (loss)	9,315	(1,276)	40,527	7,637
Other (income) and expense, net	91		91	
Income (loss) before interest and income taxes	9,224	(1,276)	40,436	7,637
Interest and other expense on debt	2,237	602	3,868	1,629
Income (loss) before income taxes	6,987	(1,878)	36,568	6,008
Income tax provision (benefit)	851	(641)	12,163	2,280
Net income (loss)	$ 6,136	$ (1,237)	$ 24,405	$ 3,728
Earnings per share:				
Net income (loss) per share - basic	$ 0.56	$ (0.11)	$ 2.23	$ 0.34
Weighted average shares outstanding - basic	10,937	10,909	10,936	10,903
Net income (loss) per share - diluted	$ 0.56	$ (0.11)	$ 2.23	$ 0.34
Weighted average shares outstanding - diluted	10,951	10,909	10,949	10,916

The accompanying notes are an integral part of these statements.

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Olympic Steel, Inc.

Consolidated Statement of Cash Flows

(in thousands)

	Nine Months Ended September 30, 2011	2010
	(unaudited)	
Cash flows from (used for) operating activities:		
Net income	$ 24,405	$ 3,728
Adjustments to reconcile net income to net cash from operating activities -		
Depreciation and amortization	12,050	10,264
Assets held for sale	(4)	
Loss on disposition of property and equipment	69	25
Stock-based compensation	647	485
Other long-term assets	1,220	(935)
Other long-term liabilities	3,487	(4,774)
Long-term deferred income taxes	1,912	527
	43,786	9,320
Changes in working capital:		
Accounts receivable	(49,350)	(44,944)
Inventories	(40,731)	(69,685)
Income taxes receivable and deferred	8,750	38,178
Prepaid expenses and other	(5,861)	(527)
Accounts payable	34,379	23,440
Change in outstanding checks	9,479	647
Accrued payroll and other accrued liabilities	(10,240)	3,263
	(53,574)	(49,628)
Net cash used for operating activities	(9,788)	(40,308)
Cash flows from (used for) investing activities:		
Acquisition of Chicago Tube and Iron, net of cash acquired	(148,759)	
Capital expenditures	(24,618)	(10,733)
Proceeds from disposition of property and equipment	24	19
Proceeds from assets held for sale	675	
Net cash used for investing activities	(172,678)	(10,714)
Cash flows from (used for) financing activities:		
Credit facility revolver borrowings, net	119,225	50,050
Principal payments under capital lease obligations	(39)	
Term loan borrowings	70,000	
Term loan repayments	(2,188)	
Credit facility fees and expenses	(4,193)	(1,618)
Proceeds from exercise of stock options (including tax benefits) and employee stock purchases	34	68
Dividends paid	(654)	(653)
Net cash from financing activities	182,185	47,847

Cash and cash equivalents:		
Net change	(281)	(3,175)
Beginning balance	1,492	5,190
Ending balance	$ 1,211	$ 2,015

The accompanying notes are an integral part of these statements.

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Olympic Steel, Inc.

Supplemental Disclosures of Cash Flow Information

(in thousands)

	Nine Months Ended September 30, 2011	2010
	(unaudited)	
Cash paid during the period		
Interest paid	$ 3,089	$ 1,095
Income taxes paid (refunded)	$ 8,852	$ (36,400)
Details of acquisition		
Fair value of CTI assets acquired	$ 215,817	$
Fair value of CTI liabilities acquired	55,961	
Cash paid	159,856	
Less: Cash acquired	11,097	
Net cash paid for CTI acquisition	$ 148,759	$

The Company incurred a capital lease obligation of $1.6 million when it entered into a lease for its warehouse in Streetsboro, Ohio during the third quarter of 2011. This non-cash transaction has been excluded from the Consolidated Statement of Cash Flow for the nine months ended September 30, 2011.

Olympic Steel, Inc.

Notes to Consolidated Financial Statements

(unaudited)

September 30, 2011

(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 2011 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, 2010. All significant intercompany transactions and balances have been eliminated in consolidation.

Commencing with the July 1, 2011 acquisition of Chicago Tube and Iron Company (CTI), the Company operates in two reportable segments; flat products and tubular and pipe products. Through its flat products segment, the Company sells and distributes large volumes of processed carbon, coated, aluminum and stainless flat-rolled sheet, coil and plate products. Through its tubular and pipe products segment, the Company distributes metal tubing, pipe, bar, valve and fittings and the fabrication of pressure parts supplied to various industrial markets.

(2) Acquisition of Chicago Tube and Iron Company:

On July 1, 2011, the Company acquired all of the outstanding common shares of CTI pursuant to the terms of an Agreement and Plan of Merger dated May 18, 2011. CTI stocks, processes and fabricates metal tubing, pipe, bar, valves and fittings and pressure parts at nine operating facilities located primarily throughout the Midwestern United States. The acquisition of CTI enhances the Company s commercial opportunities by adding new product offerings to an expanded customer base and by increasing its distribution footprint.

The Company paid total cash consideration of $159.9 million, consisting of a base purchase price of $150.0 million, plus the closing cash, working capital and McNeeley purchase agreement payments (as disclosed in the Current Report on Form 8-K filed on May 18, 2011) totaling approximately $9.9 million. In addition, the Company assumed approximately $5.9 million of indebtedness and acquired $11.1 million of cash from CTI. Olympic funded its acquisition of CTI primarily with borrowings under its amended asset-based lending facility. During 2011, the Company incurred $919 thousand of direct acquisition-related costs, which are included in Administrative and general in the Consolidated Statement of Operations for the nine months ended September 30, 2011.

Purchase Price Allocation

The acquisition of CTI was accounted for under the acquisition method of accounting and, accordingly, the purchase price of $159.9 million has been allocated to the assets acquired and liabilities assumed based on estimated fair values at July 1, 2011, the date of acquisition.

The preliminary allocation of the total purchase price of CTI to the fair values of the assets acquired and liabilities assumed is as follows:

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(in thousands)	Total
Cash	$ 11,097
Accounts receivable, net	22,378
Inventories	52,248
Assets held for sale	1,939
Property and equipment	49,920
Goodwill	38,973
Intangible assets subject to amortization	13,332
Intangible assets not subject to amortization	23,425
Other current and long-term assets	2,505
Total assets acquired	215,817
Accounts payable	(10,075)
Current and long-term debt	(5,880)
Deferred income taxes, net	(29,222)
Other current and long-term liabilities	(10,784)
Total liabilities assumed	(55,961)
Net assets acquired	$ 159,856

The accompanying Consolidated Statements of Operations include the revenues and expenses of CTI since the acquisition date. CTI s net sales during the period July 1, 2011 through September 30, 2011 were $61.4 million. The Consolidated Balance Sheet as of September 30, 2011 reflects the preliminary allocation of CTI s purchase price, and is subject to change after the completion of certain deferred tax adjustments and pre-acquisition tax returns.

In connection with the acquisition of CTI, the Company identified and valued certain intangible assets, including the CTI trade name and its existing customer relationships. The trade name was recorded at $23.4 million, and is not subject to amortization. The Company determined that the trade name acquired has an indefinite life since its economic life is expected to approximate the life of CTI. Additionally, the Company recorded $13.3 million related to customer relationships, determined to be amortizable over a fifteen year useful life. The goodwill of $39.0 million is not deductible for tax purposes.

Pro Forma Financial Information

The following unaudited pro forma summary of financial results presents the consolidated results of operations as if the acquisition had occurred at January 1, 2011 and 2010, respectively, after the effect of certain adjustments, including increased depreciation expense resulting from recording fixed assets at fair value, interest expense on the acquisition debt and amortization of customer relationships, with the related tax effects. The pro forma results have been presented for comparative purposes only and are not indicative of what would have occurred had the acquisition been made as of January 1, 2011 or 2010, or of any potential results that may occur in the future.

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(in thousands, except per share amounts)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Pro forma (unaudited):		
Net sales	$ 1,062,009	$ 752,409
Net income	$ 26.823	$ 5,286
Basic earnings per common share	$ 2.45	$ 0.48
Diluted earnings per common share	$ 2.45	$ 0.48

(3) Accounts Receivable:

The Company maintained allowances for doubtful accounts and unissued credits of $3.7 million and $2.9 million at September 30, 2011 and December 31, 2010, 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.

(4) Inventories:

Inventories are stated at the lower of cost or market and include the costs of purchased metal, inbound freight, external processing and applicable labor and overhead costs. Cost for the Company s flat products segment (metal flat-rolled sheet, coil and plate products) is determined using the specific identification method.

As a result of the acquisition of CTI, certain of the Company s tubular and pipe products inventory is stated under the last-in, first-out (LIFO) method, which is not in excess of market. At September 30, 2011, approximately $38.6 million, or 13.1% of consolidated inventory, was reported under the LIFO method of accounting. The cost of the remainder of CTI s inventory is determined using a weighted average rolling first-in, first-out (FIFO) method.

An actual valuation of the inventory under the LIFO method is made at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management s estimates of expected year-end inventory levels and costs. Because estimates are subject to many factors beyond management s control, annual results may differ from interim results. Interim LIFO estimates are subject to a final year-end LIFO inventory valuation. The Company did not record a LIFO adjustment in its third quarter of 2011 because its full-year LIFO estimate anticipates prices and quantities to be below July 1, 2011 levels. As a result, there was no LIFO reserve at September 30, 2011.

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Metal inventories consist of the following:

(in thousands)	September 30, 2011	December 31, 2010
Unprocessed	$ 225,993	$ 143,410
Processed and finished	67,592	57,196
Totals	$ 293,585	$ 200,606

(5) Assets Held for Sale:
The Company acquired certain assets as part of its acquisition of CTI that have been classified as Assets held for sale on the Consolidated Balance Sheet as of September 30, 2011. The assets held for sale are comprised of certain land and a building that were used in CTI s Milwaukee, Wisconsin operation. The assets held for sale are reported at their fair market value less costs to sell, and depreciation has ceased. Subsequent to the quarter ended September 30, 2011, the Milwaukee, Wisconsin property was sold for $1.3 million.

In July 2011, the Company sold its Oakboro, North Carolina held for sale operation for a net purchase price of $675 thousand, and no gain or loss was recorded in connection with this transaction.

(6) Property and Equipment:
Property and equipment consists of the following:

(in thousands)	Depreciable Lives	September 30, 2011	December 31, 2010
Land		$ 16,193	$ 11,937
Land improvements	10	1,573	1,453
Buildings and improvements	7-30	108,669	76,058
Machinery and equipment	5-15	134,741	111,339
Furniture and fixtures	7	6,066	6,142
Computer software and equipment	5	21,189	21,005
Vehicles	5	1,201	34
Construction in progress		24,656	11,532
		314,288	239,500
Less accumulated depreciation		(131,520)	(121,266)
Net property and equipment		$ 182,768	$ 118,234

Leasehold improvements are included with buildings and improvements and are depreciated over the life of the lease or seven years, whichever is less.

Construction in progress, as of September 30, 2011, primarily consisted of payments for a new temper mill facility and equipment in Gary, Indiana, additional processing equipment at our existing facilities, costs related to the implementation of our new computer systems, and construction costs related to the suspended project in Sumter, South Carolina.

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(7) Goodwill and Intangible Assets:

The changes in the carrying amount of goodwill, by reportable segment, are as follows:

(in thousands)	Flat products	Tubular and pipe products	Total
Balance as of December 31, 2010	$ 7,083	$	$ 7,083
CTI acquisition		38,973	38,973
Balance as of September 30, 2011	$ 7,083	$ 38,973	$ 46,056

Intangible Assets, net

Intangible assets, net, consisted of the following as of September 30, 2011:

(in thousands)	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, Net
Customer relationships - subject to amortization	$ 13,332	$ (222)	$ 13,110
Trade name - not subject to amortization	23,425		23,425
	$ 36,757	$ (222)	$ 36,535

The Company had no intangible assets during the year ended December 31, 2010. All of the Company s intangible assets were recorded in connection with its July 1, 2011 acquisition of CTI (See Note 2). The intangible assets noted above were evaluated on the premise of highest and best use to a market participant, primarily utilizing the income approach valuation methodology. The useful life of the CTI trade name was determined to be indefinite primarily due to its history and reputation in the marketplace, the Company s expectation that the CTI trade name will continue to be used throughout the life of CTI, and the conclusion that there are currently no other factors identified that would limit its useful life. The useful life of the CTI customer relationships was determined to be fifteen years, based primarily on the consistent and predictable revenue source associated with existing CTI customer base, the net positive present value of which extends through the fifteen year amortization period. The Company will continue to evaluate the useful life assigned to our amortizable customer relationships in future periods.

The Company estimates that amortization expense for its intangible assets subject to amortization will be $444 thousand for the year ended December 31, 2011 and $889 thousand per year in each of the next five years.

(8) 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 in 2006. In December 2006, the Company advanced $3.2 million to OLP to cover a loan guarantee. As of September 30, 2011, the investment in and advance to OLP was valued at $2.5 million on the Company s Consolidated Balance Sheet.

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(9) Debt:

The Company s debt is comprised of the following components:

(in thousands)	Total
Asset-based revolving credit facility due June 30, 2016	$ 174,460
Term loan due June 30, 2016	67,812
Industrial revenue bond due April 1, 2018	5,880
Capital lease	1,603
Total debt	249,755
Less current amount	(9,661)
Total long-term debt	$ 240,094

The Company s principal payments over the next 5 years and thereafter are detailed in the table below:

(in thousands)	2011	2012	2013	2014	2015	2016	Thereafter
Revolver	$	$	$	$	$	$ 174,460	$
Term loan	2,188	8,750	8,750	8,750	8,750	30,624	
Industrial revenue bond		755	785	810	840	865	1,825
Other	38	158	1,407				
Total principal payments	$ 2,226	$ 9,663	$ 10,942	$ 9,560	$ 9,590	$ 205,949	$ 1,825

On July 1, 2011 the Company amended its existing asset-based revolving credit facility. The new asset-based credit facility (the ABL Credit Facility) provides for borrowings up to $335 million consisting of a revolving credit line of $265 million and a $70 million term-loan. Revolver borrowings are limited to the lesser of a borrowing base, comprised of eligible receivables and inventories, or $265 million in the aggregate. The ABL Credit Facility matures on July 1, 2016.

The ABL Credit Facility requires the Company to comply with various covenants, the most significant of which include: (i) until maturity of the ABL Credit Facility, if any commitments or obligations are outstanding and the Company s availability is less than the greater of $20 million, 12.5% of the aggregate amount of revolver commitments, or 60% of the principal balance of the term loan then outstanding, then the Company must maintain a ratio of EBITDA minus certain capital expenditures and cash taxes paid to fixed charges of at least 1.10 to 1.00 for the most recent twelve fiscal month period; (ii) limitations on dividend payments; (iii) restrictions on additional indebtedness; and (iv) limitations on investments and joint ventures. The Company has the option to borrow under its revolver based on the agent s base rate plus a premium ranging from 0.50% to 1.00% or the London Interbank Offered Rate (LIBOR) plus a premium ranging from 2.00% to 2.50%. The interest rate under the term loan is based on the agent s base rate plus a premium ranging from 1.00% to 1.50% or LIBOR plus a premium ranging from 2.50% to 3.00%.

As of September 30, 2011, $5.1 million of bank financing fees were included in Prepaid expenses and other and Other long-term assets on the accompanying Consolidated Balance Sheet. The financing fees are being amortized over the five-year term of the credit facility.

As of September 30, 2011, the Company was in compliance with its covenants and had approximately $83 million of availability under the ABL Credit Facility.

As part of the CTI acquisition, the Company assumed approximately $5.9 million of Industrial Revenue Bond indebtedness issued through the Stanly County, North Carolina Industrial Revenue and

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Pollution Control Authority (IRB). The bond matures in April 2018, with the option to provide principal payments annually, April 1st. Interest is payable monthly, with a variable rate that resets weekly. As a security for payment of the bonds, the Company obtained a direct pay letter of credit issued by JPMorgan Chase Bank, N.A. The letter of credit reduces annually by the principal reduction amount. The interest rate at September 30, 2011 was 0.2% for the IRB debt.

The Company entered into an interest rate swap agreement to reduce the impact of changes in interest rates on the above IRB. At September 30, 2011, the effect of the swap agreement on the bond was to fix the rate at 3.46 percent. The swap agreement matures April 2018, but is reduced annually by the amount of the optional principal payments on the bond. The Company is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreement. However, the Company does not anticipate nonperformance by the counterparties.

(10) Fair Value of Financial Instruments:

The Company s financial instruments include cash and cash equivalents, short-term trade receivables, derivative instruments, accounts payable and debt instruments. For short-term instruments, other than those required to be reported at fair value on a recurring basis and for which additional disclosures are included below, management concluded the historical carrying value is a reasonable estimate of fair value because of the short period of time between the origination of such instruments and their expected realization.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is an exit price concept that assumes an orderly transaction between willing market participants. Valuation techniques must maximize the use of observable inputs and minimize the use of unobservable inputs. To measure fair value, the Company applies a fair value hierarchy that is based on three levels of input, of which the first two are considered observable and the last unobservable, as follows:

Level 1 Quoted prices in active markets for identical assets and liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices that are not active; or other inputs that are observable or can be corroborated by observable market date for substantially the full term of the assets or liabilities.