

OLYMPIC STEEL INC
Form 10-Q
November 04, 2010

Table of Contents

**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, 2010

○ 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 November 4, 2010

Common stock, without par value

10,895,460

**Olympic Steel, Inc.
Index to Form 10-Q**

	Page No.
<u>Part I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Balance Sheets</u> September 30, 2010 (unaudited) and December 31, 2009 (audited)	3
<u>Consolidated Statements of Operations</u> for the three and nine months ended September 30, 2010 and 2009 (unaudited)	4
<u>Consolidated Statements of Cash Flows</u> for the nine months ended September 30, 2010 and 2009 (unaudited)	5
<u>Notes to Consolidated Financial Statements (unaudited)</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	26
<u>Item 4. Controls and Procedures</u>	27
<u>Part II. OTHER INFORMATION</u>	
<u>Item 6. Exhibits</u>	29
<u>SIGNATURES</u>	30
<u>EXHIBITS</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	

Table of Contents**Part I. FINANCIAL INFORMATION****Item 1. Financial Statements**

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

	September 30, 2010 (unaudited)	December 31, 2009 (audited)
Assets		
Cash and cash equivalents	\$ 2,015	\$ 5,190
Accounts receivable, net	96,213	51,269
Inventories, net	181,348	111,663
Income taxes receivable and deferred	3,785	41,963
Prepaid expenses and other	5,213	4,686
Total current assets	288,574	214,771
Property and equipment, at cost	232,599	222,149
Accumulated depreciation	(117,986)	(108,589)
Net property and equipment	114,613	113,560
Goodwill	7,083	6,583
Other long-term assets	5,098	3,534
Total assets	\$ 415,368	\$ 338,448
Liabilities		
Accounts payable	\$ 76,254	\$ 52,167
Accrued payroll	10,541	6,874
Other accrued liabilities	6,947	7,213
Total current liabilities	93,742	66,254
Credit facility revolver	50,050	
Other long-term liabilities	7,175	11,949
Deferred income taxes	1,160	633

Total liabilities	152,127	78,836
Shareholders' Equity		
Preferred stock		
Common stock	118,765	118,212
Retained earnings	144,476	141,400
Total shareholders' equity	263,241	259,612
Total liabilities and shareholders' equity	\$ 415,368	\$ 338,448

The accompanying notes are an integral part of these statements.

Table of Contents

Olympic Steel, Inc.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(unaudited)		(unaudited)	
Tons sold				
Direct	218,173	161,758	647,729	470,176
Toll	22,164	19,670	66,588	56,622
	240,337	181,428	714,317	526,798
Net sales	\$ 209,185	\$ 121,599	\$ 589,842	\$ 384,898
Costs and expenses				
Cost of materials sold (excludes items shown separately below, includes \$81,063 of inventory lower of cost or market adjustments for the nine months ended September 30, 2009)	171,730	91,391	473,676	390,431
Warehouse and processing	13,436	9,748	37,057	29,526
Administrative and general	9,388	7,855	28,600	25,183
Distribution	5,176	3,806	14,312	11,386
Selling	6,164	2,855	14,845	8,971
Occupancy	1,297	1,188	3,940	4,203
Depreciation	3,270	2,897	9,775	8,581
Total costs and expenses	210,461	119,740	582,205	478,281
Operating income (loss)	(1,276)	1,859	7,637	(93,383)
Interest and other expense on debt	602	567	1,629	1,861
Income (loss) before income taxes	(1,878)	1,292	6,008	(95,244)
Income tax provision (benefit)	(641)	621	2,280	(36,628)
Net income (loss)	\$ (1,237)	\$ 671	\$ 3,728	\$ (58,616)

Earnings per share:

Net income (loss) per share	basic	\$ (0.11)	\$ 0.06	\$ 0.34	\$ (5.39)
Weighted average shares outstanding	basic	10,909	10,894	10,903	10,884
Net income (loss) per share	diluted	\$ (0.11)	\$ 0.06	\$ 0.34	\$ (5.39)
Weighted average shares outstanding	diluted	10,909	10,909	10,916	10,884

The accompanying notes are an integral part of these statements.

4

Table of Contents

Olympic Steel, Inc.
Consolidated Statements of Cash Flows
For the Nine Months Ended September 30,
(in thousands)

	2010	2009
	(unaudited)	
Cash flows from (used for) operating activities:		
Net income (loss)	\$ 3,728	\$ (58,616)
Adjustments to reconcile net income (loss) to net cash from operating activities -		
Depreciation and amortization	10,264	8,941
(Gain) loss on disposition of property and equipment	25	(11)
Stock-based compensation	485	(767)
Other long-term assets	(2,553)	1,239
Other long-term liabilities	(4,774)	(2,559)
Long-term deferred income taxes	527	(1,417)
	7,702	(53,190)
Changes in working capital:		
Accounts receivable	(44,944)	23,269
Inventories	(69,685)	148,421
Income taxes receivable and deferred	38,178	(29,921)
Prepaid expenses and other	(527)	(1,046)
Accounts payable	23,440	(3,221)
Change in outstanding checks	647	(18,532)
Accrued payroll and other accrued liabilities	3,263	(15,191)
	(49,628)	103,779
Net cash from (used for) operating activities	(41,926)	50,589
Cash flows from (used for) investing activities:		
Capital expenditures	(10,733)	(10,754)
Proceeds from disposition of property and equipment	19	12
Net cash used for investing activities	(10,714)	(10,742)
Cash flows from (used for) financing activities:		
Credit facility revolver borrowings (payments), net	50,050	(38,758)
Proceeds from exercise of stock options (including tax benefit) and employee stock purchases	68	211
Dividends paid	(653)	(978)

Net cash from (used for) financing activities	49,465	(39,525)
Cash and cash equivalents:		
Net change	(3,175)	322
Beginning balance	5,190	891
Ending balance	\$ 2,015	\$ 1,213

The accompanying notes are an integral part of these statements.

Table of Contents

Olympic Steel, Inc.

Notes to Consolidated Financial Statements

(unaudited)

September 30, 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.

Outstanding checks of \$13.9 million, \$10.2 million, \$1.7 million, \$20.3 million and \$13.9 million, as of September 30, 2010, December 31, 2009, September 30, 2009, December 31, 2008 and December 31, 2007, respectively, represent checks issued that have not yet been presented for payment to the banks and are classified as accounts payable in the Company's Consolidated Balance Sheet. The Company typically funds these overdrafts through normal collections of funds or transfers from bank balances at other financial institutions.

In June 2010, the Company revised the presentation of changes of outstanding checks from a financing activity to an operating activity in its Consolidated Statement of Cash Flows with a conforming change to the prior period presentation. The effect of this revision had no impact on the net increase (decrease) in cash; however, it changed the cash provided by operating activities for the nine-month period ended September 30, 2009 and the years ended December 31, 2009, 2008 and 2007 from \$69.1 million, \$67.4 million, \$6.2 million and \$64.7 million, respectively, as previously disclosed in the quarterly report on Form 10-Q for the quarterly period ended September 30, 2009 and the Annual Reports on Form 10-K for the years ended December 31, 2009 and 2008, to \$50.6 million, \$57.3 million, \$12.5 million and \$61.7 million, respectively, with a corresponding change in the cash flows provided by (used in) financing activities for the nine month period ended September 30, 2009 and the years ended December 31, 2009, 2008 and

Table of Contents

2007 from \$(58.1) million, \$(51.2) million, \$19.9 million and \$(51.4) million, respectively, to \$(39.5) million, \$(41.1) million, \$13.6 million and \$(48.4) million, respectively.

(2) Accounts Receivable:

The Company maintained allowances for doubtful accounts and unissued credits of \$4.7 million and \$2.1 million at September 30, 2010 and December 31, 2009, respectively. The increase in the allowance for doubtful accounts relates primarily to a customer that unexpectedly ceased operations in the third quarter of 2010. The allowance for doubtful accounts is maintained at a level management considers 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.

(3) Inventories:

Steel inventories consist of the following:

(in thousands)	September 30, 2010	December 31, 2009
Unprocessed	\$ 126,037	\$ 86,071
Processed and finished	55,311	25,592
 Totals	 \$ 181,348	 \$ 111,663

In 2009, the Company was required under U.S. 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), which resulted 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.

Table of Contents

(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 September 30, 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:

On June 30, 2010, the Company entered into a new asset-based revolving credit facility (the ABL Facility). The ABL Facility provides for a revolving credit line of \$125 million (which may be increased up to \$175 million subject to the Company obtaining commitments for such increase). Borrowings are limited to the lesser of a borrowing base, comprised of eligible receivables and inventories, or \$125 million in the aggregate. The ABL Facility matures on June 30, 2015.

The ABL Facility requires the Company to comply with various covenants, the most significant of which include:

(i) until maturity of the ABL Facility, if any commitments or obligations are outstanding and the Company's availability is less than the greater of \$20 million or 15% of the aggregate amount of revolver commitments, 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 based on the agent's base rate plus a premium ranging from 1.00% to 1.50% or the London Interbank Offered Rate (LIBOR) plus a premium ranging from 2.50% to 3.00%.

As of September 30, 2010, the Company was in compliance with its covenants and had approximately \$73 million of availability under the ABL Facility.

Table of Contents**(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 September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
Weighted average basic shares outstanding	10,909	10,894	10,903	10,884
Assumed exercise of stock options and issuance of stock awards		15	13	
Weighted average diluted shares outstanding	10,909	10,909	10,916	10,884
Net income (loss)	\$ (1,237)	\$ 671	\$ 3,728	\$ (58,616)
Basic earnings (loss) per share	\$ (0.11)	\$ 0.06	\$ 0.34	\$ (5.39)
Diluted earnings (loss) per share	\$ (0.11)	\$ 0.06	\$ 0.34	\$ (5.39)
Anti-dilutive securities outstanding	140	24	138	180

(7) Derivative Instruments:

During 2010, the Company entered into nickel swaps indexed to the London Metal Exchange (LME) price of nickel with a third-party broker. The nickel swaps are treated as derivatives for accounting purposes. We enter into them to mitigate the risk of volatility in the price of nickel. The nickel swaps vary in length from one to five months and are settled with the broker at maturity. The economic benefit or loss arising from the changes in fair value of the swaps is contractually passed through to the customer. The primary risk associated with the nickel swaps is the ability of our customer to honor its agreement with the Company related to derivative instruments. If the customer is unable to honor its agreement, the Company's risk of loss is the fair value of the nickel swap.

While these derivatives are intended to help us manage risk, they have not been designated as hedging instruments. The periodic changes in fair value of the nickel and embedded customer derivative instruments are included in Cost of materials sold in the accompanying Consolidated Statement of Operations. We recognize derivative positions with both the customer and the third

Table of Contents

party for the derivatives and we classify cash settlement amounts associated with them as part of Cost of materials sold in the Consolidated Statements of Operations.

The fair value of our derivative instruments are set forth below. The fair value is determined based on quoted market prices and reflect the estimated amounts the Company would pay or receive to terminate the nickel swaps.

Fair Value of Derivative Instruments Not Designated as Hedges As of September 30, 2010				
	Assets		Liabilities	
	Current	Fair value	Current	Fair value
(in thousands)				
Nickel swaps	\$ 38	\$ 38	\$	\$
Embedded customer derivatives			41	41
Total derivative fair value	\$ 38	\$ 38	\$ 41	\$ 41

The embedded customer derivatives are included in Other accrued liabilities and the nickel swaps are included in Accounts receivable, net on the Consolidated Balance Sheet at September 30, 2010.

As of September 30, 2010, we had received \$3 thousand of net derivative gains that we had not yet settled under the embedded customer derivative agreement. Settlement of these liabilities is expected to occur during the fourth quarter of 2010. There was no net impact of the derivatives to the Company's Consolidated Statement of Operations for the three and nine months ended September 30, 2010. The table below shows the impact of the derivatives for the nine months ended September 30, 2010.

	Net Gain (Loss) Recognized
(in thousands)	
Nickel swaps	\$ (79)
Embedded customer derivatives	79
Total	\$

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the liability in an orderly transaction

Table of Contents

between market participants on the measurement date. Valuation techniques must maximize the use of observable inputs and minimize the use of unobservable inputs.

The fair value of the Company's nickel swaps and embedded customer derivatives is determined by using Level 2 inputs. The inputs used include the price of nickel indexed to the LME. The following table presents information about the Company's asset and liabilities that were measured at fair value on a recurring basis and indicates the fair value hierarchy of the valuation techniques utilized by the Company.

(in thousands)	Fair Value Measurements at September 30, 2010			
	Level 1	Level 2	Level 3	Total
Nickel swaps	\$	\$ 38	\$	\$ 38
Embedded customer derivatives		(41)		(41)
	\$	\$ (3)	\$	\$ (3)

(8) 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.

To the extent possible, shares of treasury stock are used to satisfy shares resulting from the exercise of stock options. All options are vested and 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)	For the Three Months		For the Nine Months Ended September	
	Ended September 30, 2010	2009	2010	2009
Stock option expense before taxes	\$	\$ 53	\$ 60	\$ 158
Stock option expense after taxes	\$	\$ 32	\$ 38	\$ 97
Impact per basic share	\$	\$	\$	\$ 0.01
Impact per diluted share	\$	\$	\$	\$ 0.01

Table of Contents

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 2009 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, 2010:

	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	(4,000)	12.32		
Canceled				
Outstanding at September 30, 2010	51,007	\$ 19.83	4.8 years	\$ 389
Exercisable at September 30, 2010	51,007	\$ 19.83	4.8 years	\$ 389

The total intrinsic value of stock options exercised during the nine months ended September 30, 2010 and 2009 was \$44 thousand and \$227 thousand, respectively. The fair value of options vested during the nine months ended September, 2010 and 2009 totaled \$60 thousand and \$158 thousand, respectively.

By June 30, 2010, all expense with respect to non-vested stock option awards had been recognized and amortized into expense.

(9) Restricted Stock Units and Performance Share Units:

The Olympic Steel 2007 Omnibus Incentive Plan (the Plan) was approved by the Company's Board of Directors and 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.

Table of Contents

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.

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 and nine months ended September 30, 2010 and 2009, respectively, is summarized in the following table:

Table of Contents

(in thousands, except per share data)	For the Three Months		For the Nine Months Ended September 30,	
	Ended September 30,		2010	2009
	2010	2009	2010	2009
Stock award expense (reversal) before taxes	\$ 142	\$ (479)	\$ 425	\$ (924)
Stock award expense (reversal) after taxes	\$ 86	\$ (288)	\$ 264	\$ (569)
Impact per basic share	\$ 0.01	\$ (0.02)	\$ 0.02	\$ (0.05)
Impact per diluted share	\$ 0.01	\$ (0.02)	\$ 0.02	\$ (0.05)

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

The following table summarizes the activity related to RSUs for the nine months ended September 30, 2010:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2009	21,600	\$ 28.84	
Granted	32,202	33.85	
Converted into shares	(7,200)	21.63	
Forfeited			
Outstanding at September 30, 2010	46,602	\$ 33.41	\$ 8
Vested at September 30, 2010	21,600	\$ 28.84	\$ 8

There was no intrinsic value for the RSUs that were converted into shares in 2009. During the nine months ended September 30, 2010, 7,200 RSUs were converted into shares. There were no RSUs converted into shares during the nine months ended September 30, 2009.

The following table summarizes the activity related to PERSUs for the nine months ended September 30, 2010:

Table of Contents

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2009	86,668	\$ 25.77	
Granted		\$	
Converted into shares		\$	
Lapsed based on performance criteria		\$	
Forfeited		\$	
Outstanding at September 30, 2010	86,668	\$ 25.77	\$ 59
Vested at September 30, 2010		\$	\$

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

(10) Income Taxes:

For the first nine months of 2010, the Company recorded an income tax provision of \$2.3 million, or 37.9%, compared to an income tax benefit of \$36.6 million, or 38.5%, for the first nine 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 a cash refund of \$38.2 million received in April 2010.

(11) Supplemental Cash Flow Information:

Interest paid during the first nine months of 2010 totaled \$1.1 million, compared to \$1.7 million in the first nine months of 2009. Income taxes refunded, net of income taxes paid, during the first nine months of 2010 and 2009, respectively, totaled \$36.4 million and \$2.0 million.

(12) Impact of Recently Issued Accounting Pronouncements:

There were no accounting pronouncements issued during the first nine months of 2010 expected to have a future material impact on Olympic's financial statements.

Table of Contents

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.

Overview

We are a leading U.S. metals 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 metal producers and manufacturers that require processed metal 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 equipment, automobiles, food service and electrical equipment, military vehicles and equipment, as well as general and plate fabricators and metal service centers. We distribute our products primarily through a direct sales force.

We operate as a single business segment with 15 strategically located processing and distribution facilities in Connecticut, Georgia, Illinois, Iowa, Michigan, Minnesota, North Carolina, Ohio, Pennsylvania, and Washington. In the third quarter of 2010, we purchased our 16th facility for \$1.4 million, which is located in Mt. Sterling, Kentucky. The facility is expected to become operational in the first quarter of 2011. The Company did not renew its lease in South Carolina and no longer operates there. Our geographic footprint allows us to focus on regional customers

Table of Contents

and larger national and multi-national accounts, primarily located throughout the midwestern, eastern and southern United States.

We sell a broad range of 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; metal pricing, demand and availability; energy prices; pricing and availability of raw materials used in the production of metals; inventory held in the supply chain; customer demand for metal; customers' ability to manage their credit line availability; and layoffs or work stoppages by our own, our suppliers or our customers' personnel. The metals industry also continues to be affected by the global consolidation of our suppliers, competitors and end-use customers.

Like many other service centers, we maintain substantial inventories of metal to accommodate the short lead times and just-in-time delivery requirements of our customers. Accordingly, we purchase metal 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 metal are generally at prevailing market prices in effect at the time we place our orders. When metal 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 metal 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 metal inventory.

Table of Contents

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 U.S. 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 \$81.1 million pre-tax charge for the nine months ended September 30, 2009.

Due to the 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. During 2010, variable operating expenses have increased related to increased shipment levels. In order to meet increased customer production schedules, headcount, the use of temporary labor and overtime hours have all increased over 2009. In addition, during the end of the first and second quarters, we phased in restorations for pay originally reduced in 2009. The impact of the pay restorations was approximately \$373 thousand in the third quarter of 2010 and \$623 thousand for the first nine months of 2010.

At September 30, 2010, we employed approximately 1,059 people. Approximately 174 of the hourly plant personnel at our Detroit and Minneapolis facilities are represented by three separate collective bargaining units. A collective bargaining agreement covering our Detroit workers expires August 31, 2012. A collective bargaining agreement covering our Minneapolis plate facility workers expires March 31, 2012. A new collective bargaining agreement was reached covering our Minneapolis coil facility workers, which expires September 30, 2015. We have never 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

Table of Contents

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, 2009.

Results of Operations

The following table sets forth certain income statement data for the three and nine months ended September 30, 2010 and 2009 (dollars are shown in thousands):

	For the Three Months Ended September 30,		2009		For the Nine Months Ended September 30,		2009	
	2010	% of net sales	2009	% of net sales	2010	% of net sales	2009	% of net sales
	\$		\$		\$		\$	
Net sales	\$209,185	100.0%	\$121,599	100.0%	\$589,842	100.0%	\$384,898	100.0%
Gross profit								
(1)	37,455	17.9%	30,208	24.8%	116,166	19.7%	(5,533)	(1.4%)
Operating expenses (2)	38,731	18.5%	28,349	23.3%	108,529	18.4%	87,850	22.8%
Operating income (loss)	\$ (1,276)	(0.6%)	\$ 1,859	1.5%	\$ 7,637	1.3%	\$ (93,383)	(24.3%)

(1) Gross profit is calculated as net sales less the cost of materials sold (as defined in the Consolidated Statement of Operations) and includes \$81.1 million of inventory lower of cost or market adjustment for the nine months ended September 30, 2009.

(2) Operating expenses are calculated as total costs and expenses less

the cost of
materials sold.

Tons sold increased 32.5% to 240 thousand in the third quarter of 2010 from 181 thousand in the third quarter of 2009. Tons sold in the third quarter of 2010 included 218 thousand from direct sales and 22 thousand from toll processing, compared with 162 thousand direct tons and 19 thousand toll tons in the comparable period of last year. Tons sold increased 35.6% to 714 thousand in the first nine months of 2010 from 527 thousand in the first nine months of 2009. Tons sold in the first nine months of 2010 included 648 thousand from direct sales and 66 thousand from toll processing, compared with 470 thousand direct tons and 57 thousand toll tons

Table of Contents

in the comparable period of last year. Tons sold in the first nine months of 2010 were higher in substantially all of the Company's markets, compared to 2009. In 2009, tons sold were significantly depressed due to the impact of the global economic crisis.

Net sales increased 72.0% to \$209.2 million in the third quarter of 2010 from \$121.6 million in the third quarter of 2009. Net sales increased 53.2% to \$589.8 million in the first nine months of 2010 from \$384.9 million in the first nine months of 2009. Average selling prices in the third quarter of 2010 were \$870 per ton, compared with \$670 per ton in the third quarter of 2009, and \$843 per ton in the second quarter of 2010. The increase in sales was due to increased shipments and higher selling prices in 2010 than 2009. We expect normal seasonal patterns to negatively impact our tons sold and net sales at the end of the fourth quarter of 2010.

As a percentage of net sales, gross profit (as defined in the table above) totaled 17.9% in the third quarter of 2010 compared to 24.8% in the third quarter of 2009. For the first nine months of 2010, gross margins increased to 19.7% from (1.4%) in the first nine months of 2009. The first nine months of 2009 gross margin results included \$81.1 million inventory lower of cost or market adjustments recorded at the end of the first and second quarters. Gross margins were adversely impacted in the third quarter of 2010 by (i) falling market prices for carbon and stainless steel products, (ii) the mix of sales, and (iii) market share growth. In 2010, a larger percentage of sales have been made to the lower margin automotive industry, and we have increased our sales of stainless steel, which carries a lower gross margin percentage than carbon products. We have also increased sales volume in 2010 at lower margins in order to gain market share in a recovering economy.

Operating expenses in the third quarter of 2010 increased \$10.4 million from the third quarter of 2009. Operating expenses in the first nine months of 2010 increased \$20.7 million from the first nine months of 2009. As a percentage of net sales, operating expenses decreased to 18.5% for the third quarter of 2010 from 23.3% in the comparable 2009 period. As a percentage of net sales, operating expenses decreased to 18.4% for the first nine months of 2010 from 22.8% in the comparable 2009 period. During 2010, variable operating expenses such as distribution and selling costs have increased as a result of increased shipment levels. In order to meet increased customer production schedules, headcount, the use of temporary labor and overtime hours have all increased. In addition, during the end of the first and second quarters of 2010, we phased in restorations for pay originally reduced in 2009. The impact of the pay restorations was

Table of Contents

approximately \$373 thousand in the third quarter of 2010 and \$623 thousand for the first nine months of 2010. Operating expenses for the third quarter of 2010 include a one-time charge of \$2.1 million of bad debt expense related to a customer that unexpectedly ceased operations in the third quarter. This charge was included in the caption Selling on the accompanying Consolidated Statement of Operations. For the first nine months of 2010, bad debt expense totaled \$2.8 million, compared to \$425 thousand for the first nine months of 2009. For the first nine months of 2010, \$130 thousand related to unamortized bank fees under the Company's former revolving credit facility (the former Credit Facility) was expensed and included in the caption Administrative and general on the accompanying Consolidated Statement of Operations. Increased depreciation expense is associated with the capitalization of our new business system and other capital projects completed in 2009.

Interest and other expense on debt totaled \$602 thousand for the third quarter of 2010 compared to \$567 thousand for the third quarter of 2009. Interest and other expense on debt totaled \$1.6 million for the first nine months of 2010 compared to \$1.9 million for the first nine months of 2009. Our effective borrowing rate, exclusive of deferred financing fees and commitment fees, was 4.6% for the first nine months of 2010 compared to 3.7% for the first nine months of 2009. The decrease in interest and other expense on debt in 2010 was primarily attributable to lower amounts of borrowings.

For the third quarter of 2010, loss before income taxes totaled \$1.9 million compared to income of \$1.3 million in the third quarter of 2009. For the first nine months of 2010, income before income taxes totaled \$6.0 million, compared to a loss before income taxes of \$95.2 million in the first nine months of 2009. An income tax provision of 37.9% was recorded for the first nine months of 2010, compared to an income tax benefit of 38.5% for the first nine 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 a cash refund of \$38.2 million received in April 2010. Income taxes refunded, net of income taxes paid, during the first nine months of 2010 and 2009, respectively, totaled \$36.4 million and \$2.0 million.

Net loss for the third quarter of 2010 totaled \$1.2 million or \$0.11 per basic and diluted share, compared to net income of \$671 thousand or \$0.06 per basic and diluted share for the third quarter of 2009. Net income for the first nine months of 2010 totaled \$3.7 million or \$0.34 per

Table of Contents

basic and diluted share, compared to a net loss of \$58.6 million or \$5.39 per basic and diluted share for the first nine months of 2009.

Liquidity and Capital Resources

Our principal capital requirements include funding working capital needs, purchasing, upgrading and acquiring processing equipment, facilities and other businesses, business information and technology systems, 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, 2010 totaled \$194.8 million, a \$46.3 million increase from December 31, 2009. The increase was primarily attributable to a \$44.9 million increase in accounts receivable and a \$69.7 million increase in inventories (both resulting from higher sales volumes and higher prices for metals), partially offset by a \$38.2 million decrease in income taxes receivable and deferred (related to the receipt of a \$38.2 million income tax refund in April 2010), a \$24.1 million increase in accounts payable (associated with higher inventory levels) and a \$3.4 million increase in accrued expenses.

For the nine months ended September 30, 2010, we used \$41.9 million of net cash for operations, including \$49.6 million, which was used for working capital.

During the first nine months of 2010, we spent \$10.7 million on capital expenditures. The expenditures were primarily attributable to the continued investments associated with our new business system implementations and value-added equipment in existing facilities. In the third quarter of 2010, we purchased our 16th facility which is located in Mt. Sterling, Kentucky and which is expected to become operational in the first quarter of 2011. During the remainder of 2010, we expect to continue to invest in our business systems, value-added equipment and maintenance-type capital expenditures. In November 2010, the Company signed agreements to purchase a new temper mill and cut-to-length line, with plans to locate it on United States Steel Corporation's (U.S. Steel) Gary Works facility in Gary, Indiana. Terms of the agreement with U.S. Steel are being finalized, and are subject to change. The Company expects to invest approximately \$25 million in the new temper mill project. The project includes the purchase of an approximate 150,000 square foot facility to house a cut-to-length line, a four-high temper mill, and multiple pieces of plate burning equipment. The temper mill equipment is expected to

Table of Contents

be operational in the first quarter of 2012. Once fully operational, the new equipment, depending on steel processed, adds 150,000 to 180,000 new tons of tempered sheet capacity annually.

We continue to successfully implement our new business systems. During the first nine months of 2010, we expensed \$955 thousand and capitalized \$3.0 million associated with the implementation of the systems. Since the project began in 2006, we have expensed \$9.4 million and capitalized \$14.8 million associated with the project.

During the first nine months of 2010, \$49.5 million of cash was provided from financing activities, which primarily consisted of borrowings under our revolving credit facility.

In November 2010, our Board of Directors approved a regular quarterly dividend of \$0.02 per share, which is payable on December 15, 2010 to shareholders on record as of December 1, 2010. Our Board of Directors previously approved 2010 regular quarterly dividends of \$0.02 per share, which were paid on March 15, 2010, June 15, 2010 and September 15, 2010. Dividend distributions in the future are subject to the availability of cash, the \$2.5 million annual limitation on cash dividends under our ABL Facility, as defined below, and continuing determination by our Board of Directors that the payment of dividends remains in the best interest of our shareholders.

On June 30, 2010, the Company entered into a new asset-based revolving credit facility (the ABL Facility). The ABL Facility provides for a revolving credit line of \$125 million (which may be increased up to \$175 million subject to the Company obtaining commitments for such increase). Borrowings are limited to the lesser of a borrowing base, comprised of eligible receivables and inventories, or \$125 million in the aggregate. The ABL Facility matures on June 30, 2015.

The ABL Facility requires the Company to comply with various covenants, the most significant of which include:

- (i) until maturity of the ABL Facility, if any commitments or obligations are outstanding and the Company's availability is less than the greater of \$20 million or 15% of the aggregate amount of revolver commitments, 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.

Table of Contents

The Company has the option to borrow based on the agent's base rate plus a premium ranging from 1.00% to 1.50% or the London Interbank Offered Rate (LIBOR) plus a premium ranging from 2.50% to 3.00%.

For the nine months ended September 30, 2010, \$130 thousand related to unamortized bank fees under the former Credit Facility was expensed and included in the caption Administrative and general on the accompanying Consolidated Statement of Operations.

As of September 30, 2010, the Company was in compliance with its covenants and had approximately \$73 million of availability under the ABL Facility.

We believe that funds available under the ABL Facility (including its \$50 million accordion feature) and lease arrangement proceeds, together with funds generated from operations, will be sufficient to provide us with the liquidity necessary to fund anticipated working capital requirements, capital expenditure requirements, and our dividend payments over at least the next 12 months. In the future, we may, as part of our business strategy, acquire companies or assets in the same or complementary lines of business, or enter into and exit strategic alliances and joint ventures. We intend to finance any acquisitions with either cash, cash generated from operations, borrowings under available credit facilities, proceeds from debt or equity offerings and/or the issuance of common stock. Accordingly, the timing and size of our capital requirements are subject to change as business conditions warrant and opportunities arise.

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, project, 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

Table of Contents

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, 2009, and the following:

the ability to successfully finalize an agreement with U.S. Steel for the purchase of a facility in Gary, Indiana, and to place the facility in operation on the expected timeframe;

fluctuations in metal demand and metal pricing;

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

access to capital and global credit markets;

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

the cyclical and volatility within the metals industry;

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

the ability of our customers to honor their agreements related to derivative instruments;

customer, supplier and competitor consolidation, bankruptcy or insolvency;

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, including the new temper mill and cut-to-length line;

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

the successes of our strategic efforts and initiatives to increase sales volumes, maintain or improve working capital turnover and free cash flows, reduce costs and improve inventory turnover and improve our 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 systems;

the timing and outcome of our joint venture's efforts and ability to liquidate its remaining real estate;

Table of Contents

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

our ability to generate free cash flow through operations, reduce inventory and to repay debt within anticipated time frames; and

the recently enacted federal healthcare legislation's impact on the healthcare benefits required to be provided by us and the impact of such legislation on our compensation and administrative costs.

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. Quantitative and Qualitative 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 2008 followed by rapid and steep steel price declines during 2009. Rapidly declining prices, as we experienced during 2009, reduced our gross profit margin percentages to levels that were lower than our historical levels, and resulted in inventory lower of cost or market adjustments. Higher inventory levels held by us, other service centers or end-use customers could cause competitive pressures that could also reduce gross profit. Lower raw material costs for steel producers could result in customer demands for lower cost product, resulting in lower selling prices. 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.

Table of Contents

Declining steel prices have generally adversely affected our net sales and net income, while increasing steel prices have generally favorably affected our net sales and net income.

Approximately 12.6% of our net sales in the first nine months of 2010 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 recent bankruptcies, is emerging from significant restructuring.

Inflation generally affects us by increasing the cost of employee wages and benefits, transportation services, processing equipment, energy and borrowings under our ABL 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.

We are exposed to the impact of fluctuating steel prices and interest rate changes. During the first nine months of 2010 we entered into nickel swaps at the request of our customers. While these derivatives are intended to be effective in helping us manage risk, they have not been designated as hedging instruments. For certain customers, we enter into contractual relationships that entitle us to pass-through the economic effect of trading positions that we take with other third parties on our customers' behalf.

Our primary interest rate risk exposure results from variable rate debt. We have not entered into any interest rate hedge transactions for speculative purposes or otherwise. However, we do have the option to enter into 30- to 180-day fixed base rate Euro loans under the ABL Facility.

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

Table of Contents

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, 2010, 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 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

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

Exhibit	Description of Document	Reference
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

Table of Contents

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: November 4, 2010

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 and Treasurer
(Principal Financial and Accounting
Officer)

30