

OLYMPIC STEEL INC  
Form 10-Q  
November 06, 2014

---

---

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, 2014

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  
(State or other jurisdiction of incorporation or  
organization)

34-1245650  
(I.R.S. Employer Identification Number)

22901 Millcreek Boulevard, Suite 650, Highland Hills,  
OH  
(Address of principal executive offices)

44122  
(Zip Code)

Edgar Filing: OLYMPIC STEEL INC - Form 10-Q

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:

Large accelerated filer ( )                      Accelerated filer (X)  
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 (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 6, 2014
Common stock, without par value	10,982,136

---

---



Olympic Steel, Inc.

Index to Form 10-Q

	<u>Page No.</u>
<b>Part I. FINANCIAL INFORMATION</b>	<b>3</b>
<b>Item 1. <i>Financial Statements</i></b>	<b>3</b>
Consolidated Balance Sheets –September 30, 2014 (unaudited) and December 31, 2013 (audited)	<b>3</b>
Consolidated Statements of Comprehensive Income– for the three and nine months ended September 30, 2014 and 2013 (unaudited)	<b>4</b>
Consolidated Statements of Cash Flows– for the nine months ended September 30, 2014 and 2013 (unaudited)	<b>5</b>
Supplemental Disclosures of Cash Flow Information – for the nine months ended September 30, 2014 and 2013 (unaudited)	<b>6</b>
Notes to Unaudited Consolidated Financial Statements	<b>7</b>
<b>Item 2. <i>Management’s Discussion and Analysis of Financial Condition and Results of Operations</i></b>	<b>17</b>
<b>Item 3. <i>Quantitative and Qualitative Disclosures About Market Risk</i></b>	<b>26</b>
<b>Item 4. <i>Controls and Procedures</i></b>	<b>27</b>
<b>Part II. OTHER INFORMATION</b>	<b>28</b>
<b>Item 6. <i>Exhibits</i></b>	<b>28</b>
<b>SIGNATURES</b>	<b>29</b>

**Part I. FINANCIAL INFORMATION****Item 1. Financial Statements****Olympic Steel, Inc.****Consolidated Balance Sheets**

(in thousands)

	<b>As of</b>	
	<b>September</b>	<b>December</b>
	<b>30, 2014</b>	<b>31, 2013</b>
	(unaudited)	(audited)
<b>Assets</b>		
Cash and cash equivalents	\$9,090	\$3,186
Accounts receivable, net	152,668	115,288
Inventories, net (includes LIFO debit of \$2,972 as of September 30, 2014 and \$3,572 as of December 31, 2013)	329,432	286,371
Prepaid expenses and other	9,419	12,786
Total current assets	500,609	417,631
Property and equipment, at cost	368,089	361,368
Accumulated depreciation	(185,400)	(170,484)
Net property and equipment	182,689	190,884
Goodwill	40,787	40,787
Intangible assets, net	33,868	34,535
Other long-term assets	14,735	13,512
Total assets	\$772,688	\$697,349
<b>Liabilities</b>		
Current portion of long-term debt	\$3,530	\$13,090
Accounts payable	121,382	126,012
Accrued payroll	9,973	10,723
Other accrued liabilities	15,362	15,808
Total current liabilities	150,247	165,633
Credit facility revolver	269,475	146,075
Long-term debt	-	40,104
Other long-term liabilities	14,447	13,445
Deferred income taxes	30,716	33,476
Total liabilities	464,885	398,733
<b>Shareholders' Equity</b>		
Preferred stock	-	-

Edgar Filing: OLYMPIC STEEL INC - Form 10-Q

Common stock	125,974	124,118
Accumulated other comprehensive loss	(274 )	(437 )
Retained earnings	182,103	174,935
Total shareholders' equity	307,803	298,616
Total liabilities and shareholders' equity	\$772,688	\$697,349

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

**Olympic Steel, Inc.****Consolidated Statements of Comprehensive Income**

(in thousands, except per share data)

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<i>(unaudited)</i>			
Net sales	\$376,617	\$303,990	\$1,109,577	\$972,858
Costs and expenses				
Cost of materials sold (excludes items shown separately below)	305,080	240,974	891,968	768,980
Warehouse and processing	24,926	20,953	70,071	63,019
Administrative and general	18,260	15,617	55,342	51,937
Distribution	10,941	8,739	31,787	26,694
Selling	6,304	5,986	19,305	18,942
Occupancy	2,348	2,200	7,644	7,121
Depreciation	4,418	5,124	15,339	15,718
Amortization	223	223	667	667
Total costs and expenses	372,500	299,816	1,092,123	953,078
Operating income	4,117	4,174	17,454	19,780
Other income (loss), net	(20 )	(1 )	(22 )	(18 )
Income before interest and income taxes	4,097	4,173	17,432	19,762
Interest and other expense on debt	1,602	1,689	5,134	5,055
Income before income taxes	2,495	2,484	12,298	14,707
Income tax provision	939	1,144	4,471	5,678
Net income	\$1,556	\$1,340	\$7,827	\$9,029
Net gain (loss) on interest rate hedge	141	(66 )	265	146
Tax effect on interest rate hedge	(54 )	25	(102 )	(56 )
Total comprehensive income	\$1,643	\$1,299	\$7,990	\$9,119
Earnings per share:				
Net income per share - basic	\$0.14	\$0.12	\$0.70	\$0.82
Weighted average shares outstanding - basic	11,120	11,066	11,118	11,061
Net income per share - diluted	\$0.14	\$0.12	\$0.70	\$0.82
Weighted average shares outstanding - diluted	11,120	11,077	11,119	11,071

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





**Olympic Steel, Inc.****Consolidated Statements of Cash Flows****For the Nine Months Ended September 30,**

(in thousands)

	<b>2014</b>	<b>2013</b>
	(unaudited)	
Cash flows from (used for) operating activities:		
Net income	\$7,827	\$9,029
Adjustments to reconcile net income to net cash from (used for) operating activities -		
Depreciation and amortization	16,867	17,391
Loss on disposition of property and equipment	33	104
Stock-based compensation	1,719	1,178
Other long-term assets	(954 )	(3,967 )
Other long-term liabilities	(1,595 )	(355 )
	23,897	23,380
Changes in working capital:		
Accounts receivable	(37,380 )	(18,637 )
Inventories	(43,061 )	44,252
Prepaid expenses and other	3,367	(18 )
Accounts payable	5,418	(5,462 )
Change in outstanding checks	(10,048 )	5,041
Accrued payroll and other accrued liabilities	(1,196 )	29
	(82,900 )	25,205
Net cash from (used for) operating activities	(59,003 )	48,585
Cash flows from (used for) investing activities:		
Capital expenditures	(7,214 )	(9,590 )
Proceeds from disposition of property and equipment	37	8
Net cash used for investing activities	(7,177 )	(9,582 )
Cash flows from (used for) financing activities:		
Credit facility revolver borrowings	506,591	312,802
Credit facility revolver repayments	(383,191)	(344,632)
Principal payments under capital lease obligations	-	(1,407 )
Term loan repayments	(48,854 )	(6,562 )
Industrial revenue bond repayments	(810 )	(785 )
Credit facility fees and expenses	(1,130 )	(3 )
Proceeds from exercise of stock options (including tax benefits) and employee stock purchases	137	458
Dividends paid	(659 )	(657 )

Edgar Filing: OLYMPIC STEEL INC - Form 10-Q

Net cash from (used for) financing activities	72,084	(40,786 )
Cash and cash equivalents:		
Net change	5,904	(1,783 )
Beginning balance	3,186	7,782
Ending balance	\$9,090	\$5,999

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

**Olympic Steel, Inc.**

**Supplemental Disclosures of Cash Flow Information**

**For the Nine Months Ended September 30,**

(in thousands)

	<b>2014</b>	<b>2013</b>
	(unaudited)	
Interest paid	\$4,348	\$4,055
Income taxes paid	\$3,714	\$7,532

At September 30, 2013, the Company accrued \$3.0 million to construction in progress related to its St. Paul, Minnesota expansion for the tubular and pipe products segment. The non-cash transaction was recorded to “Property and equipment, at cost” and “Other accrued liabilities” on the accompanying Balance Sheet as of September 30, 2013 and has been excluded from the Consolidated Statement of Cash Flows for the nine months ended September 30, 2013.

*The accompanying notes are an integral part of these consolidated statements.* **Olympic Steel, Inc.**

**Olympic Steel, Inc.**

**Notes to Unaudited Consolidated Financial Statements**

**September 30, 2014**

**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 2014 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, 2013. All significant intercompany transactions and balances have been eliminated in consolidation.

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 fabricates pressure parts supplied to various industrial markets.

Corporate expenses are reported as a separate line item in the segment reporting. Corporate expenses include the unallocated expenses related to managing the entire Company (i.e., both segments), including payroll expenses for certain personnel, expenses related to being a publicly traded entity such as board of directors expenses, audit expenses, and various other professional fees.

**2. Accounts Receivable:**

Accounts receivable are presented net of allowances for doubtful accounts and unissued credits of \$3.5 million and \$3.2 million as of September 30, 2014 and December 31, 2013, 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 and unissued credits each quarter.

### **3. Inventories:**

Inventories consisted of the following:

(in thousands)	<b>Inventory as of</b>	
	<b>September 30, 2014</b>	<b>December 31, 2013</b>
Unprocessed	\$251,088	\$219,401
Processed and finished	78,344	66,970
Totals	\$329,432	\$286,371

Inventories are stated at the lower of cost or market and include the costs of purchased metals, inbound freight, external processing and applicable labor and overhead costs. Costs of our flat products segment's inventories, including flat-rolled sheet, coil and plate products are determined using the specific identification method.

The Company values certain of its tubular and pipe products inventory using the last-in, first-out (LIFO) method. At September 30, 2014 and December 31, 2013, approximately \$46.4 million, or 14.1%, of consolidated inventory, and \$43.9 million, or 15.3%, of consolidated inventory, respectively, was reported under the LIFO method of accounting. The cost of the remainder of the tubular and pipe products inventory is determined using a weighted average rolling first-in, first-out (FIFO) method.

During the third quarter of 2014, \$200 thousand of LIFO expense was recorded as the current projections anticipate increased pricing of inventory at December 31, 2014 compared to December 31, 2013. In the first quarter of 2013, the Company made an out-of-period adjustment to record previously unrecognized LIFO adjustments, which resulted in an increase to after-tax income of \$1.2 million. In the third quarter of 2013, the Company recorded \$188 thousand of LIFO income.

If the FIFO method had been in use, inventories would have been \$3.0 million lower than reported at September 30, 2014 and \$3.6 million lower than reported at December 31, 2013.

**4. Intangible Assets:**

Intangible assets, net, consisted of the following as of September 30, 2014 and December 31, 2013:

(in thousands)	<b>As of September 30, 2014</b>		
	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, Net
Customer relationships - subject to amortization	\$13,332	\$ (2,889 )	\$ 10,443
Trade name - not subject to amortization	23,425	-	23,425
	\$36,757	\$ (2,889 )	\$ 33,868

(in thousands)	<b>As of December 31, 2013</b>		
	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, Net
Customer relationships - subject to amortization	\$13,332	\$ (2,222 )	\$ 11,110
Trade name - not subject to amortization	23,425	-	23,425
	\$36,757	\$ (2,222 )	\$ 34,535

The Company estimates that amortization expense for its intangible assets subject to amortization will be \$889 thousand for the year ending December 31, 2014 and \$889 thousand per year in each of the next five years.

**5. Debt:**

The Company's debt is comprised of the following components:

(in thousands)	As of	
	September 30, 2014	December 31, 2013
Asset-based revolving credit facility due June 30, 2019	\$269,475	\$-
Asset-based revolving credit facility due June 30, 2016	-	146,075
Term loan due June 30, 2016	-	48,854
Industrial revenue bond due April 1, 2018	3,530	4,340
Total debt	273,005	199,269
Less current amount	(3,530 )	(13,090 )
Total long-term debt	\$269,475	\$186,179

On June 30, 2014, the Company amended its existing asset-based credit facility (the ABL Credit Facility). The ABL Credit Facility amendment provides for, among other things: (i) a reduction in the applicable margin for loans under the Company's Loan and Security Agreement; (ii) a consolidation of the previous \$315.0 million revolver and then outstanding \$44.5 million term loan into a \$365 million revolving credit facility; (iii) the removal of the Company's real estate as collateral for borrowings; and (iv) the extension of the maturity date until June 30, 2019. Revolver borrowings are limited to the lesser of a borrowing base, comprised of eligible receivables and inventories, or \$365 million in the aggregate. The ABL Credit Facility matures on June 30, 2019.

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 \$30 million or 10.0% of the aggregate amount of revolver commitments (\$36.5 million at September 30, 2014) then the Company must maintain a ratio of EBITDA minus certain capital expenditures and cash taxes paid to fixed charges of at least 1.00 to 1.00 for the most recent twelve fiscal month period; (ii) limitations on dividend payments; and (iii) restrictions on additional indebtedness. The Company has the option to borrow under its revolver based on the agent's base rate plus a premium ranging from 0.00% to 0.25% or the London Interbank Offered Rate (LIBOR) plus a premium ranging from 1.25% to 3.00%.

As of September 30, 2014, the Company was in compliance with its covenants and had approximately \$90 million of availability under the ABL Credit Facility.

As of September 30, 2014, \$3.6 million of bank financing fees, including \$1.1 million related to the amended ABL Credit Facility, were included in "Prepaid expenses and other" and "Other long-term assets" on the accompanying Consolidated Balance Sheets. The financing fees are being amortized over the five-year term of the ABL Credit facility and are included in "Interest and other expense on debt" on the accompanying Consolidated Statements of Comprehensive Income.

In June 2012, the Company entered into a forward starting fixed rate interest rate hedge that commenced June 2013, in order to eliminate the variability of cash interest payments on \$53.2 million of then outstanding LIBOR-based borrowings under the ABL Credit Facility. The hedge matures on June 1, 2016 and the notional amount is reduced monthly by \$729 thousand. The hedged balance as of September 30, 2014 was \$42.3 million. The interest rate hedge fixed the rate at 1.21% plus a premium ranging from 1.75% to 2.25%. Although the Company is exposed to credit loss in the event of nonperformance by the other parties to the interest rate hedge agreement, the Company anticipates performance by the counterparties.

As part of the Chicago Tube and Iron Company (CTI) acquisition in July 2011, the Company assumed approximately \$5.9 million of Industrial Revenue Bond (IRB) indebtedness issued through the Stanly County, North Carolina Industrial Revenue and Pollution Control Authority. The bond matures in April 2018, with the option to provide principal payments annually on April 1st. On April 1, 2014, the Company paid an optional principal payment of \$810 thousand. Since the IRB is remarketed annually, it is included in "Current portion of long-term debt" on the accompanying Consolidated Balance Sheets. 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, 2014 was 0.15% for the IRB debt.

CTI entered into an interest rate swap agreement to reduce the impact of changes in interest rates on the above IRB. At September 30, 2014, the effect of the swap agreement on the bond was to fix the rate at 3.46%. The swap agreement matures in April 2018, and 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.

**6. Derivative Instruments:**



*Metals swaps*

During 2014 and 2013, the Company entered into nickel swaps indexed to the London Metal Exchange (LME) price of nickel with third-party brokers. In 2014, the Company entered into carbon swaps indexed to the New York Mercantile Exchange (NYMEX) price of U.S. Midwest Domestic Hot-Rolled Coil Steel with third-party brokers. The nickel and carbon swaps are treated as derivatives for accounting purposes. The Company entered into the swaps to mitigate its customers' risk of volatility in the price of metals. The outstanding nickel swaps have one to nineteen months remaining and the outstanding carbon swaps have one to three months remaining. The swaps are settled with the brokers 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 metals swaps is the ability of customers or third-party brokers to honor their agreements with the Company related to derivative instruments. If the customer or third-party brokers are unable to honor their agreements, the Company's risk of loss is the fair value of the metals swaps.

While these derivatives are intended to help the Company manage risk, they have not been designated as hedging instruments. The periodic changes in fair value of the metals and embedded customer derivative instruments are included in "Cost of materials sold" in the Consolidated Statements of Comprehensive Income. The Company recognizes derivative positions with both the customer and the third party for the derivatives and classifies cash settlement amounts associated with them as part of "Cost of materials sold" in the Consolidated Statements of Comprehensive Income. The metals swaps are included in "Accounts receivable, net", and the embedded customer derivatives were included in "Other accrued liabilities" on the Consolidated Balance Sheets at September 30, 2014. The embedded customer derivatives were included in "Accounts receivable, net", and the metals swaps are included in "Other accrued liabilities" on the Consolidated Balance Sheets at December 31, 2013.

*Interest rate swap*

CTI entered into an interest rate swap to reduce the impact of changes in interest rates on its IRB. The swap agreement matures in April 2018, the same time as the IRB, and is reduced annually by the amount of the optional principal payments on the IRB. 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. The interest rate swap is not treated as a hedge for accounting purposes.

The periodic changes in fair value of the interest rate swap and cash settlement amounts associated with the interest rate swap are included in "Interest and other expense on debt" in the Consolidated Statements of Comprehensive Income.

*Fixed rate interest rate hedge*

In June 2012, the Company entered into a forward starting fixed rate interest rate hedge commencing June 2013 in order to eliminate the variability of cash interest payments on \$53.2 million of then outstanding LIBOR-based borrowings under the ABL Credit Facility. The hedged balance as of September 30, 2014 was \$42.3 million. The hedge matures on June 1, 2016 and is reduced monthly by \$729 thousand. The fixed rate interest rate hedge is accounted for as a cash flow hedging instrument for accounting purposes.

There was no net impact from the nickel swaps or embedded customer derivative agreements to the Company's Consolidated Statements of Comprehensive Income for the three or nine months ended September 30, 2014 and 2013. The table below shows the total impact to the Company's Consolidated Statements of Comprehensive Income through net income of the derivatives for the three and nine months ended September 30, 2014 and 2013.

	<b>Net Gain (Loss) Recognized</b>			
	<b>For the</b>		<b>For the Nine</b>	
	<b>Three</b>		<b>Months</b>	
	<b>Months</b>		<b>Months</b>	
	<b>Ended</b>		<b>Ended</b>	
	<b>September</b>		<b>September 30,</b>	
	<b>30,</b>		<b>30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
(in thousands)				
Interest rate swap (CTI)	\$(33 )	\$(21 )	\$(80 )	\$(134)

Fixed interest rate swap (ABL)	(118)	(135)	(363 )	(177)
Metals swaps	(467)	35	1,305	(981)
Embedded customer derivatives	467	(35 )	(1,305)	981
Total gain (loss)	\$(151)	\$(156)	\$(443 )	\$(311)

7. **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 data for substantially the full term of the assets or liabilities.

*Level 3* – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

During the nine months ended September 30, 2014, there were no transfers of financial assets between Levels 1, 2 or 3 fair value measurements. There have been no changes in the methodologies used September 30, 2014 since December 31, 2013. Following is a description of the valuation methodologies used for assets and liabilities measured at fair value as of September 30, 2014 and December 31, 2013:

*Metals swaps and embedded customer derivatives* – Determined by using Level 2 inputs that include the price of nickel indexed to the LME and the price of Hot Rolled Coil Steel indexed to the NYMEX. The fair value is determined based on quoted market prices and reflects the estimated amounts the Company would pay or receive to terminate the nickel swaps.

*Interest rate swaps* – Based on the present value of the expected future cash flows, considering the risks involved, and using discount rates appropriate for the maturity date. Market observable Level 2 inputs are used to determine the present value of future cash flows.

The following table presents information about the Company's assets 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)	<b>Value of Items Recorded at Fair Value As of September 30, 2014</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets:</b>				
Metals swaps	\$-	\$30	\$ -	\$30
<b>Total assets at fair value</b>	<b>\$-</b>	<b>\$30</b>	<b>\$ -</b>	<b>\$30</b>
<b>Liabilities:</b>				
Embedded customer derivative	\$-	\$30	\$ -	\$30
Interest rate swap (CTI)	-	199	-	199
Fixed interest rate swap (ABL)	-	445	-	445
<b>Total liabilities recorded at fair value</b>	<b>\$-</b>	<b>\$674</b>	<b>\$ -</b>	<b>\$674</b>

(in thousands)	<b>Value of Items Not Recorded at Fair Value As of September 30, 2014</b>	
	<b>Level 2</b>	<b>Total</b>

	<b>Level 1</b>		<b>Level 3</b>	
<b>Liabilities:</b>				
IRB	\$3,530	\$-	\$ -	\$3,530
ABL Credit Facility	-	269,475	-	269,475
<b>Total liabilities not recorded at fair value</b>	<b>\$3,530</b>	<b>\$269,475</b>	<b>\$ -</b>	<b>\$273,005</b>

The value of the items not recorded at fair value represent the carrying value of the liabilities.

(in thousands)	<b>Value of Items Recorded at Fair Value As of December 31, 2013</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets:</b>				
Embedded customer derivative	\$-	\$614	\$ -	\$614
<b>Total assets at fair value</b>	<b>\$-</b>	<b>\$614</b>	<b>\$ -</b>	<b>\$614</b>
<b>Liabilities:</b>				
Metals swaps	\$-	\$614	\$ -	\$614
Interest rate swap (CTI)	-	279	-	279
Fixed interest rate swap (ABL)	-	710	-	710
<b>Total liabilities recorded at fair value</b>	<b>\$-</b>	<b>\$1,603</b>	<b>\$ -</b>	<b>\$1,603</b>

(in thousands)	<b>Value of Items Not Recorded at Fair Value As of December 31, 2013</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Liabilities:				
IRB	\$4,340	\$-	\$ -	\$4,340
Term loan	-	48,854	-	48,854
ABL Credit Facility	-	146,075	-	146,075
<b>Total liabilities not recorded at fair value</b>	<b>\$4,340</b>	<b>\$194,929</b>	<b>\$ -</b>	<b>\$199,269</b>

The value of the items not recorded at fair value represent the carrying value of the liabilities.

The fair value of the IRB is determined using Level 1 inputs. The carrying value and the fair value of the IRB that qualify as financial instruments were \$3.5 million at September 30, 2014 and \$4.3 million at December 31, 2013.

The fair values of the revolver and term loan are determined using Level 2 inputs. The carrying value of the revolver was \$269.5 million at September 30, 2014. The carrying value of the revolver and the term loan were \$146.1 million and \$48.9 million, respectively, at December 31, 2013. The Level 2 fair value of the Company's long-term debt was estimated using prevailing market interest rates on debt with similar credit worthiness, terms and maturities.

#### 8. Equity Plans:

##### Stock Options

The following table summarizes stock option activity during the nine months ended September 30, 2014:

<b>Number of</b>	<b>Weighted Average</b>	<b>Weighted Average Remaining</b>	<b>Aggregate Intrinsic Value</b>
----------------------	-----------------------------	---------------------------------------	--

	<b>Options</b>	<b>Exercise Price</b>	<b>Contractual Term (in Years)</b>	<b>(in thousands)</b>
Outstanding at December 31, 2013	27,172	\$ 27.40		
Granted	-	-		
Exercised	(7,000 )	12.32		
Canceled	-	-		
Outstanding at September 30, 2014	20,172	\$ 32.63	2.6	\$ -
Exercisable at September 30, 2014	20,172	\$ 32.63	2.6	\$ -

There were 7,000 and 11,667 stock options exercised during the nine months ended September 30, 2014 and 2013, respectively. The total intrinsic value of stock options exercised during the nine months ended September 30, 2014 and 2013 was \$103 thousand and \$218 thousand, respectively. All stock options outstanding are vested as of September 30, 2014.

### **Restricted Stock Units and Performance Share Units**

Pursuant to the Olympic Steel 2007 Omnibus Incentive Plan (Plan), the Company may 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 March 1, 2014 and January 2, 2013, the Compensation Committee of the Company's Board of Directors approved the grant of 2,544 and 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.

The fair value of each RSU was estimated to be the closing price of the Company's common stock on the date of the grant, which was \$27.51 and \$23.41 for the grants on March 1, 2014 and January 2, 2013, respectively.

The Company's Senior Management Compensation Program includes an equity component in order to encourage more ownership of common stock by the senior management. The Senior Management Compensation Program imposes stock ownership requirements upon the participants. Each participant is required to own at least 750 shares of common stock for each year that the participant participates in the Senior Management Compensation Program. Any participant that fails to meet to the stock ownership requirements will be ineligible to receive any equity awards under the Company's equity compensation plans, including the Plan, until the participant satisfies the ownership requirements. To assist participants in meeting the stock ownership requirements, on an annual basis, if a participant purchases 500 shares of common stock on the open market, the Company will award that participant 250 shares of common stock. During the nine months ended September 30, 2014 and 2013, the Company matched 8,375 and 7,000 shares, respectively. Additionally, any participant who continues to comply with the stock ownership requirements as of the five-year, 10-year, 15-year, 20-year and 25-year anniversaries of the participant's participation in the Senior Management Compensation Program will receive a restricted stock unit award with a dollar value of \$25 thousand, \$50 thousand, \$75 thousand, \$100 thousand and \$100 thousand, respectively. Restricted stock unit awards will convert into the right to receive shares of common stock upon a participant's retirement, or earlier upon the participant's death or disability or upon a change in control of the Company.

Stock-based compensation expense recognized on RSUs for the nine months ended September 30, 2014 and 2013, respectively, is summarized in the following table:

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
(in thousands, except per share data)	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
RSU expense before taxes	\$360	\$238	\$881	\$688
RSU expense after taxes	225	129	561	422
Impact per basic share	0.02	0.01	0.05	0.04
Impact per diluted share	\$0.02	\$0.01	\$0.05	\$0.04

All pre-tax charges related to RSUs were included in the caption "Administrative and general" on the accompanying Consolidated Statements of Comprehensive Income.

The following table summarizes the activity related to RSUs for the nine months ended September 30, 2014:

<b>Number of</b>	<b>Weighted Average</b>	<b>Aggregate Intrinsic Value</b>
----------------------	-----------------------------	--



	<b>Shares</b>	<b>Granted Price</b>	<b>(in thousands)</b>
Outstanding at December 31, 2013	230,958	\$ 25.44	
Granted	34,226	27.69	
Converted into shares	(1,250 )	23.56	
Forfeited	-	-	
Outstanding at September 30, 2014	263,934	\$ 25.74	\$ 11
Vested at September 30, 2014	225,265	\$ 26.02	\$ 7

During the nine months ended September 30, 2014, 1,250 RSUs were converted into shares. No RSUs were converted into shares during the nine months ended September 30, 2013.

### **9. Income Taxes:**

For the three months ended September 30, 2014, the Company recorded an income tax provision of \$0.9 million, or 37.6%, compared to \$1.1 million, or 46.1%, for the three months ended September 30, 2013.

For the nine months ended September 30, 2014, the Company recorded an income tax provision of \$4.5 million, or 36.4%, compared to \$5.7 million, or 38.6%, for the nine months ended September 30, 2013. The lower effective tax rate for the three and nine months ended September 30, 2014 was a result of a discrete foreign income tax item recorded in the second quarter of 2014.

Our tax provision for interim periods is determined using an estimate of our annual effective tax rate, adjusted for discrete items that are taken into account in the relevant period. Each quarter we update our estimate of the annual effective tax rate, and if our estimated tax rate changes, we make a cumulative adjustment.

Our quarterly tax provision and our quarterly estimate of our annual effective tax rate is subject to significant volatility due to several factors, including variability in accurately predicting our pre-tax and taxable income and loss and the mix of jurisdictions to which they relate, changes in law and relative changes of expenses or losses for which tax benefits are not recognized. Additionally, our effective tax rate can be more or less volatile based on the amount of pre-tax income. For example, the impact of discrete items and non-deductible expenses on our effective tax rate is greater when our pre-tax income is lower.

**10. Shares Outstanding and Earnings Per Share:**

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

(in thousands, except per share data)	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Weighted average basic shares outstanding	11,120	11,066	11,118	11,061
Assumed exercise of stock options and issuance of stock awards	-	11	1	10
Weighted average diluted shares outstanding	11,120	11,077	11,119	11,071
Net income	\$1,556	\$1,340	\$7,827	\$9,029
Basic earnings per share	\$0.14	\$0.12	\$0.70	\$0.82
Diluted earnings per share	\$0.14	\$0.12	\$0.70	\$0.82
Anti-dilutive securities outstanding	200	199	200	201

**11. Segment Information:**

The Company follows the accounting guidance that requires the utilization of a “management approach” to define and report the financial results of operating segments. The management approach defines operating segments along the lines used by the Company’s chief operating decision maker (CODM) to assess performance and make operating and resource allocation decisions. Our CODM evaluates performance and allocates resources based primarily on operating income. Our operating segments are based primarily on internal management reporting.

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 fabricates pressure parts supplied to various industrial markets.

Corporate expenses are reported as a separate line item in the segment reporting. Corporate expenses include the unallocated expenses related to managing the entire Company (i.e., both segments), including payroll expenses for certain personnel, expenses related to being a publicly traded entity such as board of directors expenses, audit expenses, and various other professional fees.



The following table provides financial information by segment and reconciles the Company's operating income by segment to the consolidated income before income taxes for the three and nine months ended September 30, 2014 and 2013.

(in thousands)	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Net sales				
Flat products	\$312,776	\$248,463	\$918,834	\$791,655
Tubular and pipe products	63,841	55,527	190,743	181,203
Total net sales	\$376,617	\$303,990	\$1,109,577	\$972,858
Depreciation and amortization				
Flat products	\$3,233	\$4,104	\$11,682	\$12,589
Tubular and pipe products	1,383	1,243	4,249	3,796
Corporate	25	-	75	-
Total depreciation and amortization	\$4,641	\$5,347	\$16,006	\$16,385
Operating income				
Flat products	\$3,365	\$2,624	\$14,628	\$12,429
Tubular and pipe products	2,804	3,297	9,094	13,066
Corporate	(2,052 )	(1,747 )	(6,268 )	(5,715 )
Total operating income	\$4,117	\$4,174	\$17,454	\$19,780
Other income (loss), net	(20 )	(1 )	(22 )	(18 )
Income before interest and income taxes	4,097	4,173	17,432	19,762
Interest and other expense on debt	1,602	1,689	5,134	5,055
Income before income taxes	\$2,495	\$2,484	\$12,298	\$14,707

(in thousands)	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Capital expenditures				
Flat products	\$1,631	\$1,541	\$4,861	\$2,937
Tubular and pipe products	459	7,308	2,332	9,691
Corporate	-	-	21	-
Total capital expenditures	\$2,090	\$8,849	\$7,214	\$12,628

**As of**

(in thousands)	<b>September 30, 2014</b>	<b>December 31, 2013</b>
Goodwill		
Flat products	\$ 500	\$ 500
Tubular and pipe products	40,287	40,287
Total goodwill	\$40,787	\$ 40,787
Assets		
Flat products	\$543,912	\$473,397
Tubular and pipe products	228,193	223,314
Corporate	583	638
Total assets	\$772,688	\$ 697,349

There were no material revenue transactions between the flat products and tubular and pipe products segments.

The Company sells certain products internationally, primarily in Canada, Puerto Rico and Mexico. International sales are immaterial to the consolidated financial results and to the individual segments' results.

**12. Recently Issued Accounting Updates:**

In May 2014, the Financial Accounting Standards Board issued ASU No. 2014-09, "Revenue from Contracts with Customers." This ASU is a joint project initiated by the Financial Accounting Standards Board and the International Accounting Standards Board to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. generally accepted accounting principles and International Financial Reporting Standards that will remove inconsistencies and weaknesses in revenue requirements; provide a more robust framework for addressing revenue issues; improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets; provide more useful information to users of financial statements through improved disclosure requirements; and simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is in the process of determining the method of adoption and assessing the impact of this ASU on its consolidated financial statements.

In August 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-15, "Presentation of Financial Statements-Going Concern". This ASU contains new guidance on management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Management must evaluate whether it is probable that known conditions or events, considered in the aggregate, would raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. If such conditions or events are identified, the standard requires management's mitigation plans to alleviate the doubt or a statement of the substantial doubt about the entity's ability to continue as a going concern to be disclosed in the financial statements. The standards update is effective for fiscal years and interim periods beginning after December 15, 2016, with early adoption permitted. The adoption of this standards update is not expected to impact the Company's consolidated 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, 2013. The following Management's Discussion and Analysis of Financial Condition and Results of Operations contain 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, 2013. 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.

### **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," "plan" and "continue," as well as the negative of these terms or similar expressions, are intended to identify forward-looking statements, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those implied by such statements including, but not limited to:

- general and global business, economic, financial and political conditions, including the ongoing effects of the global economic recovery;
- access to capital and global credit markets;
- competitive factors such as the availability, global production levels and pricing of metals, industry shipping and inventory levels and rapid fluctuations in customer demand and metals pricing;
- cyclicality and volatility within the metals industry;
- the ability of our customers (especially those that may be highly leveraged, and those with inadequate liquidity) to maintain their credit availability;
- the ability of our newer locations to achieve expected results;
- events or circumstances that could adversely impact the successful operation of our processing equipment and operations;
- the ability to comply with the terms of our asset-based credit facility;

the ability of our customers and third parties 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, our suppliers' or customers' personnel;  
the impacts of union organizing activities and the success of union contract renewals;  
the availability and costs of transportation and logistical services;  
the amounts, successes and our ability to continue our capital investments and strategic growth initiatives and our business information system implementations;  
the successes of our operational excellence initiatives to improve our operating, cultural and management systems and reduce our costs;  
the successes of our strategic efforts and initiatives to increase sales volumes, maintain or improve working capital turnover and free cash flows, improve our customer service, and achieve cost savings;  
the timing and outcomes of inventory lower of cost or market adjustments;  
the inflation or deflation existing within the metals industry, as well as our product mix and inventory levels on hand, which can impact our cost of materials sold as a result of the fluctuations in the last-in, first-out, or LIFO, inventory reserve;  
the adequacy of our existing information technology and business system software;  
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 and decreased future capital expenditures, reduce inventory and repay debt within anticipated time frames;  
events or circumstances that could impair or adversely impact the carrying value of any of our assets;  
risks and uncertainties associated with intangible assets, including potential impairment charges;  
the 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;  
unanticipated developments that could occur with respect to contingencies such as litigation and environmental matters, including any developments that would require any increase in our costs for such contingencies; and those risks set forth in Item 1A (Risk Factors), as found in our Annual Report on Form 10-K for the year ended December 31, 2013.



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.

## Overview

We are a leading metals service center that operates in two reportable segments; flat products and tubular and pipe products. We provide metals processing and distribution services for a wide range of customers. Our primary flat products 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. Through our Chicago Tube and Iron subsidiary, or CTI, we distribute metal tubing, pipe, bar, valves and fittings and fabricate pressure parts supplied to various industrial markets. Products that require more value-added processing generally have a higher gross profit. Accordingly, our overall gross profit is affected by, among other things, product mix, the amount of processing performed, the demand for and availability of metals, and volatility in selling prices and material purchase costs. We also perform toll processing of customer-owned metals. We sell certain products internationally, primarily in Canada, Puerto Rico and Mexico. International sales are immaterial to our consolidated financial results and to the individual segments' 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; metals pricing, demand and availability; energy prices; pricing and availability of raw materials used in the production of metals; global supply and inventory held in the supply chain; 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 other service centers, we maintain substantial inventories of metals to accommodate the short lead times and just-in-time delivery requirements of our customers. Accordingly, we purchase metals 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 metals are generally at prevailing market prices in effect at the time we place our orders. When metals 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 gross profits of our business could be adversely affected. When metals prices decline, customer demands for lower prices and our competitors' responses to those demands could result in lower sale prices and, consequently, lower gross profits as we sell existing metals inventory.

Edgar Filing: OLYMPIC STEEL INC - Form 10-Q

At September 30, 2014, we employed approximately 1,840 people. Approximately 325 of the hourly plant personnel at the facilities listed below are represented by ten separate collective bargaining units. The table below shows the expiration dates of the collective bargaining agreements.

<b>Facility</b>	<b>Expiration date</b>
Proctor, Minnesota	December 21, 2014
Locust, North Carolina	March 4, 2015
Romeoville, Illinois	May 31, 2015
Minneapolis coil, Minnesota	September 30, 2015
Indianapolis, Indiana	January 29, 2016
Minneapolis plate, Minnesota	March 31, 2017
Detroit, Michigan	August 31, 2017
St. Paul, Minnesota	May 25, 2018
Milan, Illinois	August 12, 2018

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.

## **Reportable Segments**

We operate in two reportable segments; flat products and tubular and pipe products. We follow the accounting guidance that requires the utilization of a “management approach” to define and report the financial results of operating segments. The management approach defines operating segments along the lines used by the chief operating decision maker, or CODM, to assess performance and make operating and resource allocation decisions. Our CODM evaluates performance and allocates resources based primarily on operating income. Our operating segments are based primarily on internal management reporting.

Corporate expenses are reported as a separate line item in the segment reporting. Corporate expenses include the unallocated expenses related to managing the entire Company (i.e., both segments), including payroll expenses for certain personnel, expenses related to being a publicly traded entity such as board of directors expenses, audit expenses, and various other professional fees.

### ***Flat products***

The primary focus of our flat products segment 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 metals producers and manufacturers that require processed metals for their operations. We serve customers in most metals 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 metals service centers. We distribute these products primarily through a direct sales force.

The flat products segment has 24 strategically-located processing and distribution facilities in the United States and one in Monterrey, Mexico. 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. The flat products segment distributes these products primarily through a direct sales force.

### ***Tubular and pipe products***

The tubular and pipe products segment consists of the CTI business, acquired in 2011. Founded in 1914, CTI operates from ten locations in the midwestern and southeastern United States and distributes tube and pipe products from some flat products locations as well. The tubular and pipe products segment distributes its products primarily through a direct sales force.

Through our tubular and pipe products segment, we distribute metals tubing, pipe, bar, valve and fittings and fabricate pressure parts supplied to various industrial markets. The Company values certain of its tubular and pipe products inventory using the last-in, first-out, or LIFO, method. At September 30, 2014 and December 31, 2013, approximately \$46.4 million, or 14.1%, of consolidated inventory, and \$43.9 million, or 15.3%, of consolidated inventory, respectively, was reported under the LIFO method of accounting. The cost of the remainder of the tubular and pipe products inventory is determined using a weighted average rolling first-in, first-out, or FIFO, method. During periods of rising prices, the LIFO method of accounting increases the cost of goods sold (through LIFO expense) resulting in lower earnings than if FIFO inventory valuation had been used. During periods of decreasing metals pricing, the LIFO method of accounting decreases the cost of good sold (through LIFO income) resulting in higher earnings than if FIFO inventory valuation had been used.

**Results of Operations****Consolidated Operations**

The following table presents consolidated operating results for the periods indicated (dollars are shown in thousands):

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,				
	2014	% of net sales	2013	2014	% of net sales	2013	% of net sales	
Net sales	\$376,617	100.0	\$303,990	100.0	\$1,109,577	100.0	\$972,858	100.0
Cost of materials sold (a)	305,080	81.0	240,974	79.3	891,968	80.4	768,980	79.0
Gross profit (b)	71,537	19.0	63,016	20.7	217,609	19.6	203,878	21.0
Operating expenses (c)	67,420	17.9	58,842	19.3	200,155	18.0	184,098	19.0
Operating income	\$4,117	1.1	\$4,174	1.4	\$17,454	1.6	\$19,780	2.0
Other income (loss), net	(20 )	-	(1 )	-	(22 )	-	(18 )	-
Interest and other expense on debt	1,602	0.4	1,689	0.6	5,134	0.5	5,055	0.5
Income before income taxes	2,495	0.7	2,484	0.8	12,298	1.1	14,707	1.5
Income taxes	939	0.3	1,144	0.4	4,471	0.4	5,678	0.6
Net income	1,556	0.4	1,340	0.4	7,827	0.7	9,029	0.9

(a) Includes \$200 and \$600 of LIFO expense for the three and nine months ended September 30, 2014, respectively, and \$188 and \$2,495 of LIFO income for the three and nine months ended September 30, 2013, respectively (inclusive of a \$1,932 out of period LIFO income adjustment recorded in the first quarter of 2013).

(b) Gross profit is calculated as net sales less the cost of materials sold.

(c) Operating expenses are calculated as total costs and expenses less the cost of materials sold.

Net sales increased 23.9% to \$376.6 million in the third quarter of 2014 from \$304.0 million in the third quarter of 2013. Flat products net sales were 83.0% of total net sales in the third quarter of 2014 compared to 81.7% of total net sales in the third quarter of 2013. Tubular and pipe products net sales were 17.0% of total net sales in the third quarter of 2014 compared to 18.3% of total net sales in the third quarter of 2013. The increase in net sales was due to a 21.4% increase in sales volume and a 2.0% increase in selling prices during the third quarter of 2014 compared to the third quarter of 2013. The average direct selling price increased 2.8% in the flat products segment and 6.3% in the tubular and pipe products segment during the third quarter of 2014 compared to the third quarter of 2013.

Net sales increased 14.1% to \$1.1 billion during the nine months ended September 30, 2014 from \$972.9 million during the nine months ended September 30, 2013. Flat products net sales were 82.8% of total net sales during the nine months ended September 30, 2014 compared to 81.4% of total net sales during the nine months ended September 30, 2013. Tubular and pipe products net sales were 17.2% of total net sales during the nine months ended September 30, 2014 compared to 18.6% of total net sales during the nine months ended September 30, 2013. The increase in net sales was due to a 13.5% increase in sales volume and a 0.5% increase in selling prices during the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013. The average direct selling price increased 1.9% in the flat products segment during the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013, but decreased 3.3% in the tubular and pipe products segment during the nine months ended September 30, 2014 compared to the same period in 2013.

Cost of materials sold increased 26.6% to \$305.1 million in the third quarter of 2014 from \$241.0 million in the third quarter of 2013. During the third quarter of 2014, we recorded \$200 thousand of LIFO expense compared to \$188 thousand of LIFO income in the third quarter of 2013. The increase in cost of materials sold in 2014 is primarily due to increased sales volumes of 21.4%, increased metals prices of 4.3% in the third quarter of 2014 compared to the third quarter of 2013, and the impact of LIFO expense during the three months ended September 30, 2014 compared to LIFO income during the three months ended September 30, 2013.

Cost of materials sold increased 16.0% to \$892.0 million during the nine months ended September 30, 2014 from \$769.0 million during the nine months ended September 30, 2013. During the nine months ended September 30, 2014, we recorded LIFO expense of \$600 thousand compared to \$2.5 million of LIFO income during the nine months ended September 30, 2013. In the first quarter of 2013, we made an out-of-period adjustment to record previously unrecognized LIFO adjustments, which resulted in a decrease to cost of materials sold of \$1.9 million. The increase in cost of materials sold in 2014 is primarily due to increased sales volume of 13.5%, increased metals prices of 2.2% during the first nine months of 2014 compared to the first nine months of 2013, and the impact of LIFO expense during the nine months ended September 30, 2014 compared to LIFO income during the nine months ended September 30, 2013.

As a percentage of net sales, gross profit (as defined in footnote (b) in the table above) decreased to 19.0% in the third quarter of 2014 compared to 20.7% in the third quarter of 2013. The decrease in gross profit for the nine months ended September 30, 2014 was primarily due to an increase in the mix of flat products segment sales with lower gross margins than pipe and tube segment sales, lower gross margins year-over-year in each segment due to competitive pressures, and the impact of LIFO expense in the third quarter of 2014 compared to LIFO income in the third quarter of 2013.

As a percentage of net sales, gross profit (as defined in footnote (b) in the table above) decreased to 19.6% in the nine months ended September 30, 2014 compared to 21.0% in the nine months ended September 30, 2013. As a percentage of net sales, the LIFO income adjustment in 2013 increased gross profit by 0.3%. The decrease in the gross profit as percentage of sales for the nine months ended September 30, 2014 was primarily due to an increase in the mix of flat product segment sales which have a lower gross margin than pipe and tube segment sales, lower gross margins year-over-year due to competitive pressures, and the impact of LIFO expense recorded in 2014 compared to the LIFO income adjustment made in 2013. We expect our gross profit in the fourth quarter of 2014 to be consistent with the third quarter of 2014.

Operating expenses in the third quarter of 2014 increased \$8.6 million, or 14.6%, to \$67.4 million from \$58.8 million in the third quarter of 2014. As a percentage of net sales, operating expenses decreased to 17.9% for the third quarter of 2014 from 19.3% in the comparable 2013 period. Operating expenses in the flat products segment increased \$5.3 million, operating expenses in the tubular and pipe products segment increased \$3.0 million and Corporate expenses increased \$0.3 million. Variable operating expenses, such as distribution, warehouse and processing, and selling expenses, increased \$6.5 million, or 18.2%, as a result of the 21.4% sales volume and 23.9% net sales increase. In addition, distribution expenses also increased as a result of inflationary pressures in the transportation industry. The increase of \$0.1 million in occupancy expense is primarily related to expanded warehouse facilities. Depreciation expense decreased \$0.7 million due to certain assets being fully depreciated in 2014.

Operating expenses in the first nine months of 2014 increased \$16.1 million, or 8.7%, to \$200.2 million from \$184.1 million in the first nine months of 2013. As a percentage of net sales, operating expenses decreased to 18.0% for the nine months ended September 30, 2014 from 19.0% in the comparable 2013 period. Operating expenses in the flat products segment increased \$11.6 million, operating expenses in the tubular and pipe products segment increased \$3.9 million and Corporate expenses increased \$0.6 million. Variable operating expenses, such as distribution, warehouse and processing, and selling expenses, increased \$12.5 million, or 11.5%, as a result of the 13.5% sales volume increase and the 14.1% net sales increase. In addition, distribution expenses increased as a result of inflationary pressures in the transportation industry. Occupancy expenses increased \$0.5 million as a result of our expanded warehouse facilities. Administrative and general expenses increased \$3.4 million as a result of increased non-income taxes, employee training and benefit costs and non-recurring costs related to CTI's Centennial events in 2014. Depreciation expense decreased \$0.4 million as a result of certain assets being fully depreciated in 2014.

Interest and other expense on debt totaled \$1.6 million, or 0.4% of net sales, in the third quarter of 2014 compared to \$1.7 million, or 0.6% of net sales, in the third quarter of 2013. Interest and other expense on debt totaled \$5.1 million, or 0.5% of net sales, in both the first nine months of 2014 and 2013. Our effective borrowing rate, exclusive of deferred financing fees and commitment fees, was 2.3% for the first nine months of 2014 compared to 2.2% for the first nine months of 2013. Effective with the June 30, 2014 amendment to our asset-based credit facility, our borrowing rate decreased by 25 basis points.

For both the third quarter of 2014 and 2013, income before income taxes totaled \$2.5 million. Income before income taxes included LIFO expense of \$200 thousand for the third quarter of 2014 compared to LIFO income of \$188 thousand for the third quarter of 2013. For the first nine months of 2014, income before income taxes totaled \$12.3 million compared to \$14.7 million for the first nine months of 2013. Income before income taxes included LIFO expense of \$600 thousand for the first nine months of 2014 compared to LIFO income of \$2.5 million for the first nine months of 2013.

An income tax provision of 37.6% was recorded for the third quarter of 2014, compared to 46.1% for the third quarter of 2013. An income tax provision of 36.4% was recorded for the first nine months of 2014, compared to 38.6% for the first nine months of 2013. The lower effective tax rate for the nine months ended September 30, 2014 was a result of a discrete foreign income tax item recorded in the second quarter of 2014. Our tax provision for interim periods is determined using an estimate of our annual effective tax rate, adjusted for discrete items that are taken into account in the relevant period. Each quarter, we update our estimate of the annual effective tax rate, and if our estimated tax rate changes, we make a cumulative adjustment. We expect our effective tax rate to approximate 36% to 38% on an annual basis in 2014.



Net income for the third quarter of 2014 totaled \$1.6 million or \$0.14 per basic and diluted share, compared to \$1.3 million or \$0.12 per basic and diluted share for the third quarter of 2013. Net income for the first nine months of 2014 totaled \$7.8 million or \$0.70 per basic and diluted share, compared to \$9.0 million or \$0.82 per basic and diluted share for the first nine months of 2013. For the nine months ended September 30, 2014, the impact of LIFO expense decreased earnings per share by \$0.03 per basic and diluted shares, while for the nine months ended September 30, 2013, the impact of LIFO income increased earnings per share by \$0.14 per basic and diluted shares inclusive of the out-of-period LIFO income adjustment.

## Segment Operations

### *Flat products*

The following table presents selected operating results for our flat products segment for the periods indicated (dollars are shown in thousands):

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2014		2013		2014		2013	
		% of net sales		% of net sales		% of net sales		% of net sales
Direct tons sold	295,122		244,265		872,963		776,308	
Toll tons sold	28,712		20,288		80,560		61,120	
Total tons sold	323,834		264,553		953,523		837,428	
Net sales	\$312,776	100.0	\$248,463	100.0	\$918,834	100.0	\$791,655	100.0
Average selling price per ton	966		939		964		945	
Cost of materials sold	259,843	83.1	201,579	81.1	756,587	82.3	643,241	81.3
Gross profit (a)	52,933	16.9	46,884	18.9	162,247	17.7	148,414	18.7
Operating expenses (b)	49,568	15.8	44,260	17.8	147,619	16.1	135,985	17.2
Operating income	\$3,365	1.1	\$2,624	1.1	\$14,628	1.6	\$12,429	1.5

(a) Gross profit is calculated as net sales less the cost of materials sold.

(b) Operating expenses are calculated as total costs and expenses less the cost of materials sold.

Tons sold by our flat products segment increased 22.4% to 324 thousand in the third quarter of 2014 from 265 thousand in the third quarter of 2013. Tons sold by our flat products segment increased 13.9% to 954 thousand in the first nine months of 2014 from 837 thousand in the first nine months of 2013. The increase in tons sold is due to increased customer demand associated with a recovering economy, market share gains in flat products, and increased toll business in the first nine months of 2014 compared to the first nine months of 2013.

Net sales in our flat products segment increased 25.9% to \$312.8 million in the third quarter of 2014 from \$248.5 million in the third quarter of 2013. The increase in net sales was due to a 22.4% increase in sales volume and a 2.8% increase in average selling prices, as metals industry market prices are higher year-over-year. Average selling prices in the third quarter of 2014 were \$966 per ton, compared with \$939 per ton in the third quarter of 2013 and \$969 per ton in the second quarter of 2014. 2014 market prices for flat products peaked in July and have been declining since.

Net sales in our flat products segment increased 16.1% to \$918.8 million in the first nine months of 2014 from \$791.7 million in the first nine months of 2013. The increase in sales was due to a 13.9% increase in sales volume as well as a 1.9% increase in average selling prices, as metals industry market prices are higher year-over-year. Average selling prices in the first nine months of 2014 were \$964 per ton, compared with \$945 per ton in the first nine months of 2013.

Cost of materials sold increased 28.9% to \$259.8 million in the third quarter of 2014 from \$201.6 million in the third quarter of 2013. The increase in cost of materials sold was due to a 22.4% increase in sales volume and a 5.3% increase in metals pricing during the three months ended September 30, 2014 compared to the three months ended September 30, 2013. Cost of materials sold increased 17.6% to \$756.6 million in the first nine months of 2014 from \$643.2 million in the first nine months of 2013. The increase in cost of materials sold was due to a 13.9% increase in sales volume and a 3.3% increase in metals pricing during the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013.

As a percentage of net sales, gross profit (as defined in footnote (a) in the table above) decreased to 16.9% in the third quarter of 2014 compared to 18.9% in the third quarter of 2013. As a percentage of net sales, gross profit totaled 17.7% in the nine months ended September 30, 2014 compared to 18.7% in the nine months ended September 30, 2013. The decrease in gross profit percentage for the three and nine months ended September 30, 2014 was primarily due to the competitive market pressures associated with the growth in shipments and a higher mix of toll sales and lower gross margin percentage stainless and aluminum sales versus carbon sales.

Operating expenses in the third quarter of 2014 increased \$5.3 million, or 12.0%, to \$49.6 million from \$44.3 million in the third quarter of 2013. As a percentage of net sales, operating expenses decreased to 15.8% for the third quarter of 2014 from 17.8% in the comparable 2013 period. Operating expenses in the first nine months of 2014 increased \$11.6 million, or 8.6%, to \$147.6 million from \$136.0 million in the first nine months of 2013. As a percentage of net sales, operating expenses decreased to 16.1% for the first nine months of 2014 from 17.2% in the comparable 2013 period. Variable operating expenses, such as distribution, warehouse and processing, and selling expenses, increased as a result of higher sales volume and net sales. In addition, distribution expenses increased as a result of inflationary pressures in the transportation industry. Occupancy expenses increased as a result of expanded warehouse facilities. Administrative and general expenses increased as a result of increased non-income taxes, employee training and benefit costs. Depreciation expense decreased \$0.9 million as a result of certain assets becoming fully depreciated in 2014.

Operating income for the third quarter of 2014 totaled \$3.4 million, or 1.1% of net sales, compared to operating income of \$2.6 million, or 1.1% of net sales, in the third quarter of 2013. Operating income for the first nine months of 2014 totaled \$14.6 million, or 1.6% of net sales, compared to operating income of \$12.4 million, or 1.5% of net sales, in the first nine months of 2013.

### *Tubular and pipe products*

The following table presents selected operating results for our tubular and pipe products segment for the periods indicated (dollars are shown in thousands):

	For the Three Months Ended				For the Nine Months Ended			
	September 30, 2014		2013		September 30, 2014		2013	
		% of net sales		% of net sales		% of net sales		% of net sales
Net sales	\$63,841	100.0	\$55,527	100.0	\$190,743	100.0	\$181,203	100.0
Cost of materials sold (a)	45,237	70.9	39,395	70.9	135,381	71.0	125,739	69.4

Edgar Filing: OLYMPIC STEEL INC - Form 10-Q

Gross profit (b)	18,604	29.1	16,132	29.1	55,362	29.0	55,464	30.6
Operating expenses (c)	15,800	24.7	12,835	23.1	46,268	24.2	42,398	23.4
Operating income	\$2,804	4.4	\$3,297	6.0	\$9,094	4.8	\$13,066	7.2

(a) Includes \$200 and \$600 of LIFO expense for the three and nine months ended September 30, 2014, respectively, and \$188 and \$2,495 of LIFO income for the three and nine months ended September 30, 2013, respectively (inclusive of a \$1,932 out of period LIFO income adjustment recorded in the first quarter of 2013).

(b) Gross profit is calculated as net sales less the cost of materials sold.

(c) Operating expenses are calculated as total costs and expenses less the cost of materials sold.

Net sales increased 15.0% to \$63.8 million in the third quarter of 2014 from \$55.5 million in the third quarter of 2013. The increase is a result of an 8.2% increase in sales volume and a 6.3% increase in average selling prices over the third quarter of 2013. Net sales increased 5.3% to \$190.7 million in the first nine months of 2014 from \$181.2 million in the first nine months of 2013. The increase is a result of an 8.9% increase in sales volume over 2013 resulting in market share gains for tubular and pipe products, offset by a 3.3% decline in pipe and tube products segment average selling prices as a result of the competitive market environment and an increase in the sales mix of products with a lower average selling price.

Cost of materials sold increased 14.8% to \$45.2 million in the third quarter of 2014 from \$39.4 million in the third quarter of 2013. The increase in cost of material sold in the third quarter of 2014 is primarily related to an 8.2% increase in sales volume, a 6.1% increase in metals pricing and \$200 thousand of LIFO expense recorded in the quarter compared to \$188 thousand of LIFO income recorded in the third quarter of 2013. Cost of materials sold increased 7.7% to \$135.4 million in the first nine months of 2014 from \$125.7 million in the first nine months of 2013. The increase in cost of material sold in the first nine months of 2014 is primarily related to a 8.9% increase in sales volume offset by a 1.1% decrease in metals pricing due to falling prices and \$600 thousand of LIFO expense recorded in the first nine months of 2014 compared to \$2.5 million of LIFO income recorded in the first nine months of 2013 (inclusive of an out-of-period adjustment to record previously unrecognized LIFO income adjustments, which resulted in a decrease to cost of materials sold of \$1.9 million).

As a percentage of net sales, gross profit (as defined in footnote (b) in the table above) totaled 29.1% in both the third quarter of 2014 and 2013. As a percentage of net sales, the LIFO adjustment in 2014 decreased third quarter gross profit by 0.3%, compared to an increase of 0.3% in the third quarter of 2013. As a percentage of net sales, gross profit totaled 29.0% in the first nine months of 2014 compared to 30.6% in the first nine months of 2013. As a percentage of net sales, the LIFO adjustment in the first nine months of 2014 decreased gross profit by 0.3% compared to the increase to gross profit by 1.4% in the first nine months of 2013.

Operating expenses in the third quarter of 2014 increased \$3.0 million, or 23.1%, to \$15.8 million from \$12.8 million in the third quarter of 2013. Operating expenses were 24.7% of net sales in the third quarter of 2014 compared to 23.1% in the third quarter of 2013. Operating expenses in the first nine months of 2014 increased \$3.9 million, or 9.1%, to \$46.3 million from \$42.4 million in the first nine months of 2013. Operating expenses were 24.2% of net sales in the first nine months of 2014 compared to 23.4% in the first nine months of 2013. The increase in operating expense for the three and nine months ended September 30, 2014 is primarily related to the increased distribution expense related to increased sales volumes and the inflationary pressures in the transportation industry and increased depreciation expense as a result of recent investments in processing equipment. Administrative and general expenses increased due to non-recurring costs related to CTI's Centennial events in 2014 and increased payroll costs.

Operating income for the third quarter 2014 totaled \$2.8 million, or 4.4% of net sales, compared to \$3.3 million, or 6.0% of net sales, for the third quarter of 2013. Operating income for the first nine months of 2014 totaled \$9.1 million, or 4.8% of net sales, compared to \$13.1 million, or 7.2% of net sales, for the first nine months of 2013. The LIFO adjustment decreased operating income for the third quarter of 2014 by \$200 thousand compared to an increase of \$188 thousand in the third quarter of 2013. The LIFO adjustment decreased operating income for the first nine months of 2014 by \$600 thousand compared to an increase of \$2.5 million in the first nine months of 2013.

### *Corporate expenses*

Corporate expenses include the unallocated expenses related to managing the entire Company, (i.e., both segments) including payroll expenses for certain personnel, expenses related to being a publicly traded entity such as board of directors expenses, audit expenses, and various other professional fees. Corporate expenses increased \$0.3 million in the third quarter of 2014 to \$2.0 million, compared to \$1.7 million in the third quarter of 2013. Corporate expenses increased \$0.6 million in the first nine months of 2014 to \$6.3 million, compared to \$5.7 million in the first nine months of 2013. The increase in Corporate expenses is related to the relocation of the executive offices in the second half of 2013 and other public company costs.

### **Liquidity, Capital Resources and Cash Flows**

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

We believe that funds available under our existing asset-based credit facility (the ABL Credit Facility), lease arrangement proceeds and the sale of equity or debt securities, 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, our dividend payments and any business acquisitions over at least the next 12 months. In the future, we may, as part of our business strategy, acquire and dispose of assets, enter, renew or exit from lease agreements or other companies in the same or complementary lines of business, or enter into or exit strategic alliances and joint ventures. Accordingly, the timing and size of our capital requirements are subject to change as business conditions warrant and opportunities arise.

### *Operating Activities*

For the nine months ended September 30, 2014, we used \$59.0 million of net cash for operations, of which \$23.9 million was generated from operating activities and \$82.9 million was used for working capital. For the nine months ended September 30, 2013, we generated \$48.6 million of net cash from operations, of which \$23.4 million was generated from operating activities and \$25.2 million was generated from working capital.

Net cash from operations totaled \$23.9 million during the first nine months of 2014 and was primarily generated from net income of \$7.8 million and depreciation and amortization of \$16.9 million offset primarily by changes in other long-term assets and liabilities of \$2.5 million. Net cash from operations totaled \$23.4 million during the first nine months of 2013 and was generated from net income of \$9.0 million and depreciation and amortization of \$17.4 million offset primarily by changes in other long-term assets and liabilities of \$4.3 million.

Working capital at September 30, 2014 totaled \$350.4 million, a \$98.4 million increase from December 31, 2013. The increase was primarily attributable to a \$43.1 million increase in inventory and a \$37.4 million increase in accounts receivable (resulting from higher sales volume and sales prices in the first nine months of 2014 compared to the fourth quarter of 2013, as our days of sales outstanding remained fairly consistent), and a \$4.6 million net decrease in accounts payable and outstanding checks.

### ***Investing Activities***

Net cash used for investing activities was \$7.2 million during the nine months ended September 30, 2014, compared to \$9.6 million during the nine months ended September 30, 2013. Both 2014 and 2013 capital expenditures were attributable to additional processing equipment at our existing facilities. In 2014 and 2015, we plan for capital spending to be less than our estimated annual depreciation expense.

### ***Financing Activities***

During the first nine months of 2014, \$72.1 million of cash was generated from financing activities, which primarily consisted of \$123.4 million of net borrowings under our ABL Credit Facility, including the payoff of our term loan of \$48.9 million upon refinancing and subsequent borrowings on our revolver, offset by \$1.1 million of additional deferred financing fees incurred as part of the June 30, 2014 amendment of the ABL Credit Facility, discussed below in Debt Arrangements.

Dividends paid were \$0.7 million for both the nine months ended September 30, 2014 and September 30, 2013. In November 2014, our Board of Directors approved a regular quarterly dividend of \$0.02 per share, which will be paid on December 15, 2014 to shareholders on record as of December 1, 2014. Our Board of Directors previously approved regular quarterly dividends of \$0.02 per share, which were paid on March 17, 2014, June 16, 2014 and September 16, 2014 to shareholders of record as of March 3, 2014, June 2, 2014 and September 2, 2014, respectively. Regular dividend distributions in the future are subject to the availability of cash, the \$2.5 million annual limitation on cash dividends under our ABL Credit Facility and the continuing determination by our Board of Directors that the payment of dividends remains in the best interest of our shareholders.

### ***Debt Arrangements***

On June 30, 2014, we amended our ABL Credit Facility. The amendment provides for, among other things: (i) a reduction in the applicable margin for loans under the Company's Loan and Security Agreement; (ii) a consolidation of the previous \$315.0 million revolver and then outstanding \$44.5 million term loan into a \$365 million revolving credit facility; (iii) the removal of the Company's real estate as collateral for borrowings; and (iv) the extension of the maturity date until June 30, 2019. Revolver borrowings are limited to the lesser of a borrowing base, comprised of eligible receivables and inventories, or \$365 million in the aggregate. The ABL Credit Facility matures on June 30, 2019.

The ABL Credit Facility requires us 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 our availability is less than the greater of \$30 million or 10.0% of the aggregate amount of revolver commitments (\$36.5 million at September 30, 2014) then we must maintain a ratio of EBITDA minus certain capital expenditures and cash taxes paid to fixed charges of at least 1.00 to 1.00 for the most recent twelve fiscal month period; (ii) limitations on dividend payments; and (iii) restrictions on additional indebtedness. We have the option to borrow under our revolver based on the agent's base rate plus a premium ranging from 0.00% to 0.25% or the London Interbank Offered Rate (LIBOR) plus a premium ranging from 1.25% to 3.00%.

As of September 30, 2014, we were in compliance with our covenants and had approximately \$90 million of availability under the ABL Credit Facility.

As of September 30, 2014, \$3.6 million of bank financing fees, including \$1.1 million related to the amended ABL Credit Facility were included in "Prepaid expenses and other" and "Other long-term assets" on the accompanying Consolidated Balance Sheets. The financing fees are being amortized over the remaining term of the ABL Credit Facility and are included in "Interest and other expense on debt" on the accompanying Consolidated Statements of Comprehensive Income.

As part of the 2011 CTI acquisition, we assumed approximately \$5.9 million of Industrial Revenue Bond (IRB) indebtedness issued through the Stanly County, North Carolina Industrial Revenue and Pollution Control Authority. The bond matures in April 2018, with the option to provide principal payments annually on April 1st. On April 1, 2014, we paid an optional principal payment of \$810 thousand. The IRB is remarketed annually and is included in "Current portion of long-term debt" on the accompanying Consolidated Balance Sheets. 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, 2014 was 0.15% for the IRB debt.



## **Critical Accounting Policies**

This Management's Discussion and Analysis of Financial Condition and Results of Operations is based on the consolidated financial statements included in this Quarterly Report on Form 10-Q, which have been prepared in conformity with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements. We monitor and evaluate our estimates and assumptions, based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results could differ from these estimates under different assumptions or conditions.

We review our financial reporting and disclosure practices and accounting practices quarterly to ensure they provide accurate and transparent information relative to the current economic and business environment. For further information regarding the accounting policies that we believe to be critical accounting policies 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, 2013.

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

Our principal raw materials are carbon, coated and stainless steel, and aluminum, pipe and tube, flat rolled coil, sheet and plate that we typically purchase from multiple primary metals producers. The metals industry as a whole is cyclical and, at times, pricing and availability of metals can be volatile due to numerous factors beyond our control, including general domestic and international economic conditions, labor costs, sales levels, competition, levels of inventory held by other metals service centers, consolidation of metals producers, new global capacity by metals producers, higher raw material costs for the producers of metals, import duties and tariffs and currency exchange rates. This volatility can significantly affect the availability and cost of raw materials for us.

We, like many other metals service centers, maintain substantial inventories of metals to accommodate the short lead times and just-in-time delivery requirements of our customers. Accordingly, we purchase metals 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 historic buying practices, supply agreements with customers and market conditions. Our commitments to purchase metals are generally at prevailing market prices in effect at the time we place our orders. We have no long-term, fixed-price metals purchase contracts. When metals 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 metals prices decline, customer demands for lower prices and our competitors' responses to those

demands could result in lower sale prices and, consequently, lower gross profits and inventory lower of cost or market adjustments as we sell existing inventory. Significant or rapid declines in metals prices or reductions in sales volumes could adversely impact our ability to remain in compliance with certain financial covenants in our credit facility, as well as result in us incurring inventory or goodwill impairment charges. Changing metals prices therefore could significantly impact our net sales, gross profits, operating income and net income.

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

Approximately 50.6% of our consolidated net sales in the first nine months of 2014 were directly related to industrial machinery and equipment manufacturers and their fabricators.

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

We are exposed to the impact of fluctuating metals prices and interest rate changes. During 2014 and 2013, we entered into nickel and carbon swaps at the request of 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. We are exposed to credit loss in the event of nonperformance by the other parties to the nickel and carbon swaps. However, we do not anticipate nonperformance by the counterparties.

Our primary interest rate risk exposure results from variable rate debt. We have the option to enter into 30- to 180-day fixed base rate LIBOR loans under the ABL Credit Facility. As part of the CTI acquisition we assumed an interest rate swap agreement on an IRB. The swap agreement matures in April 2018, but the notional amount may be reduced annually by the amount of the optional principal payments on the IRB. In June 2012, we entered into a forward starting fixed rate interest rate hedge commencing July 2013 in order to eliminate the variability of cash interest payments on approximately \$53.2 million of the outstanding LIBOR-based borrowings under the ABL Credit Facility. The hedged balance as of September 30, 2014 was \$42.3 million. The hedge matures on June 1, 2016 and the notional amount is reduced monthly by \$729 thousand. The fixed rate interest rate hedge is accounted for as a cash flow hedging instrument for accounting purposes. We are exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap and fixed interest rate hedge agreements. However, we do not anticipate nonperformance by the counterparties.

#### **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 Quarterly Report on Form 10-Q has been carried out under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. These disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in reports that are filed with or submitted to the SEC is: (i) accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures and (ii) recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2014, our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



**Part II. OTHER INFORMATION**

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

**Item 6. Exhibits**

<b><u>Exhibit</u></b>	<b><u>Description of Document</u></b>	<b><u>Reference</u></b>
31.1	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith
31.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith
32.1	Certification of the Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Furnished herewith
32.2	Certification of the Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Furnished herewith
101.INS	XBRL Instance Document	
101.SCH	XBRL Taxonomy Extension Schema Document	
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	
101.DEF	XBRL Taxonomy Extension Definition	
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	



**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.

Date: November 6, 2014

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

By: /s/ Michael D. Siegal  
**Michael D. Siegal**  
Chairman of the Board and Chief  
Executive Officer

By: /s/ Richard T. Marabito  
**Richard T. Marabito**  
Chief Financial Officer  
(Principal Financial and Accounting  
Officer)

**EXHIBIT INDEX**

<b><u>Exhibit</u></b>	<b><u>Description of Document</u></b>	<b><u>Reference</u></b>
31.1	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith
31.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith
32.1	Certification of the Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Furnished herewith
32.2	Certification of the Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Furnished herewith
101.INS	XBRL Instance Document	
101.SCH	XBRL Taxonomy Extension Schema Document	
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	
101.DEF	XBRL Taxonomy Extension Definition	
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	