

OREGON STEEL MILLS INC
Form 10-Q
November 01, 2005

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington DC 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, 2005

OR

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 1-9887

OREGON STEEL MILLS, INC.

(Exact name of registrant as specified in its charter)

Delaware

94-0506370

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

1000 S.W. Broadway, Suite 2200, Portland, Oregon

97205

(Address of principal executive offices)

(Zip Code)

(503) 223-9228

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

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Yes No
o x

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

Common Stock, \$.01 Par Value

35,624,523

Class

Number of Shares Outstanding
(as of October 28, 2005)

OREGON STEEL MILLS, INC.

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

OREGON STEEL MILLS, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands except per share amounts)

	September 30, 2005	December 31, 2004
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents, including restricted cash of \$22,463 and \$0	\$ 65,497	\$ 77,026
Short-term investments	8,621	60,110
Trade accounts receivable, less allowance for doubtful accounts of \$1,316 and \$4,660	118,046	118,952
Inventories	346,698	235,010
Deferred income taxes	5,958	4,680
Other	14,203	9,881
Assets held for sale	27,898	28,448
	<u>586,921</u>	<u>534,107</u>
Property, plant and equipment:		
Land and improvements	22,021	19,934
Buildings	58,525	55,736
Machinery and equipment	796,197	795,571
Construction in progress	60,599	14,779
	<u>937,342</u>	<u>886,020</u>
Accumulated depreciation	(451,008)	(434,346)
	<u>486,334</u>	<u>451,674</u>
Goodwill	4,458	520
Intangibles, net	32,955	33,396
Other assets	6,908	10,004
	<u>1,117,576</u>	<u>1,029,701</u>
TOTAL ASSETS	\$ 1,117,576	\$ 1,029,701
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	\$ 2,041	\$ 2,459
Accounts payable	71,893	79,509
Accrued expenses	58,529	61,918
Liabilities related to assets held for sale	1,010	1,160
	<u>133,473</u>	<u>145,046</u>
Total current liabilities	133,473	145,046
Long-term debt	308,720	313,699
Deferred employee benefits	81,376	76,607
Environmental liability	26,648	27,833
Deferred income taxes	31,101	5,164
Other long-term liabilities	225	138
	<u>581,543</u>	<u>568,487</u>
Total liabilities	581,543	568,487

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Minority interests	14,710	22,706
Commitments and contingencies (Note 10)		
STOCKHOLDERS EQUITY		
Preferred stock, par value \$.01 per share, 1,000 shares authorized; none issued		
Common stock, par value \$.01 per share; 45,000 shares authorized; 35,625 and 35,338 shares issued and outstanding	356	353
Additional paid-in capital	363,190	359,350
Retained earnings	167,331	90,316
Accumulated other comprehensive loss:		
Cumulative foreign currency translation adjustment	1,146	(724)
Minimum pension liability	(10,700)	(10,787)
Total stockholders equity	521,323	438,508
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 1,117,576	\$ 1,029,701

The accompanying notes are an integral part of the consolidated financial statements.

OREGON STEEL MILLS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Sales:				
Product sales	\$ 289,260	\$ 338,248	\$ 899,623	\$ 849,995
Freight	10,420	10,084	30,980	32,503
	<u>299,680</u>	<u>348,332</u>	<u>930,603</u>	<u>882,498</u>
Costs and expenses:				
Cost of sales	247,487	261,141	737,750	691,271
Labor dispute settlement charges (Note 10)	(665)	4,532	(665)	43,400
Selling, general and administrative expenses	14,969	17,672	47,351	47,686
Loss on disposal of assets	2,090	1,036	1,791	743
	<u>263,881</u>	<u>284,381</u>	<u>786,227</u>	<u>783,100</u>
Operating income	35,799	63,951	144,376	99,398
Other income (expense):				
Interest expense, net	(7,459)	(8,454)	(24,427)	(25,482)
Minority interests	(1,330)	(4,564)	(5,582)	(2,950)
Other income, net	1,168	893	4,527	2,364
	<u>28,178</u>	<u>51,826</u>	<u>118,894</u>	<u>73,330</u>
Income before income taxes	28,178	51,826	118,894	73,330
Income tax expense	<u>(7,938)</u>	<u>(1,483)</u>	<u>(41,879)</u>	<u>(1,442)</u>
Net income	<u>\$ 20,240</u>	<u>\$ 50,343</u>	<u>\$ 77,015</u>	<u>\$ 71,888</u>
Basic income per share	\$ 0.57	\$ 1.89	\$ 2.17	\$ 2.70
Diluted income per share	\$ 0.57	\$ 1.87	\$ 2.15	\$ 2.69
Weighted average common shares and common share equivalents outstanding:				
Basic	35,544	26,683	35,461	26,585
Diluted	35,818	26,924	35,760	26,753

The accompanying notes are an integral part of the consolidated financial statements.

OREGON STEEL MILLS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2005	2004
Cash flows from operating activities:		
Net income	\$ 77,015	\$ 71,888
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	29,705	29,922
Tax benefit on employee stock option plans	1,872	497
Deferred income taxes	21,335	125
Loss on disposal of assets	1,791	743
Stock compensation expense	1,435	
Minority interests	5,582	2,950
Other, net	7,185	
Changes in current assets and liabilities:		
Trade accounts receivables	906	(45,460)
Inventories	(111,264)	5,993
Operating liabilities	(16,226)	(33,275)
Labor dispute settlement charges (Note 10)	(665)	43,400
Other	(3,778)	9,596
Net cash provided by operating activities	14,893	86,379
Cash flows from investing activities:		
Purchases of short-term investments	(100,175)	
Sales and maturities of short-term investments	151,674	
Additions to property, plant and equipment	(59,429)	(15,408)
Investment in Camrose Pipe Company	(18,603)	
Other, net	638	427
Net cash used by investing activities	(25,895)	(14,981)
Cash flows from financing activities:		
Net payments under Canadian bank revolving loan facility	(1,797)	
Proceeds from bank debt		185,611
Payments on bank and long-term debt	(1,949)	(186,597)
Proceeds from issuance of common stock	1,381	953
Repurchase of 10% First Mortgage Notes	(2,173)	
Change in book overdrafts	3,943	
Net cash used by financing activities	(595)	(33)
Effects of foreign currency exchange rate changes on cash	68	27
Net increase (decrease) in cash and cash equivalents	(11,529)	71,392
Cash and cash equivalents at the beginning of period	77,026	5,770
Cash and cash equivalents at the end of period	\$ 65,497	\$ 77,162

Supplemental disclosures of cash flow information:

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Cash paid for:

Interest	\$	31,769	\$	32,462
Income taxes	\$	21,638	\$	1,251

The accompanying notes are an integral part of the consolidated financial statements.

OREGON STEEL MILLS, INC.
Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

The consolidated financial statements include all wholly-owned and those majority-owned subsidiaries over which Oregon Steel Mills, Inc. (Company) exerts management control. Non-controlled subsidiaries and affiliates are accounted for using the equity method. Material wholly-owned and majority-owned subsidiaries of the Company are wholly-owned Camrose Pipe Corporation (CPC), which does business as Columbia Structural Tubing (CST) and which, through ownership in another corporation, holds a 100 percent interest in Camrose Pipe Company (Camrose); a 60 percent interest in Oregon Feralloy Partners (OFP) and 87 percent owned New CF&I, Inc. (New CF&I), which owns a 95.2 percent interest in CF&I Steel, L.P. (CF&I). The Company also directly owns an additional 4.3 percent interest in CF&I. In January 1998, CF&I assumed the trade name Rocky Mountain Steel Mills (RMSM). New CF&I owns a 100 percent interest in the Colorado and Wyoming Railway Company. All significant inter-company balances and transactions have been eliminated.

The unaudited consolidated financial statements include estimates and other adjustments, consisting of normal recurring accruals and other charges as described in Note 10 to the Consolidated Financial Statements, *Contingencies Labor Matters CF&I Labor Dispute Settlement Accounting* which, in the opinion of management, are necessary for a fair presentation of the interim periods. Results for an interim period are not necessarily indicative of results for a full year. Reference should be made to the Company's 2004 Annual Report on Form 10-K for additional disclosures including a summary of significant accounting policies.

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 151, *Inventory Costs, an Amendment of ARB No. 43, Chapter 4*. SFAS No. 151 amends Accounting Research Bulletin 43, Chapter 4, to clarify that the abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) be recognized as current period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is in the process of assessing the impact of adopting this new standard.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets, an Amendment of APB Opinion No. 29*. The guidance in Accounting Principles Board (APB) Opinion No. 29, *Accounting for Nonmonetary Transactions*, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in APB Opinion No. 29, however, included certain exceptions to that principle. SFAS No. 153 amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary asset exchanges in fiscal periods beginning after June 15, 2005. The Company does not believe that the adoption of SFAS No. 153 will have a material impact on the consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123R (revised 2004), *Share-Based Payment*, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123R supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in Statement 123R is similar to the approach described in SFAS 123, however, SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Once effective, pro forma disclosures currently provided in Note 2 to the Consolidated Financial Statements, *Stock-Based Compensation*, in lieu of recognition of stock compensation expense, will no longer be an alternative. The Securities and Exchange Commission has amended the compliance dates originally established by SFAS No. 123R, and the adoption of this standard is required for fiscal years beginning after June 15, 2005. The Company is in the process of assessing the impact of adopting this new standard.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, which replaces APB Opinion No. 20, *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements* and requires the retrospective application to prior periods financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The retrospective application of the change would be limited to the direct effects of the change, and indirect effects would be recognized in the period of the accounting change. SFAS No. 154 is effective for fiscal years beginning after December 31, 2005. The Company does not believe that the adoption of SFAS No. 154 will have a material impact on the consolidated financial statements.

Reclassifications

Certain reclassifications have been made to the prior periods to conform to the current year presentation. Such reclassifications do not affect operating income as previously reported.

2. Stock-Based Compensation

The Company has two stock-based compensation plans to make awards of stock options to officers and key employees and non-employee directors. The Company accounts for its option plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. No stock-based compensation cost is reflected in net income from these plans, as all options granted under these plans had exercise prices equal to the market value of the underlying common stock at the date of grant. Options have a term of ten years and generally vest over one to three years from the date of the grant.

The Company did not award options during the three and nine months ended September 30, 2005. On April 29, 2004, the Company awarded options having a weighted average fair value of \$5.66 per share, derived using the following assumptions: (1) an annualized dividend yield of 0%, (2) common stock price volatility of 71.5%, (3) a 4.1% risk-free rate of return and (4) an expected option term of 7 years.

On April 28, 2005, the Company adopted the 2005 Long-Term Incentive Plan (LTIP). Under the LTIP, performance-based equity awards (Performance Shares) are earned based on the Company achieving goals within defined performance categories over a three-year period beginning January 1, 2005. The performance categories used to determine how many Performance Shares ultimately will be earned are (1) the Company's total shareholder return (TSR) relative to the TSR of the selected industry peer group and (2) the three-year average earnings before interest, taxes, depreciation and amortization (EBITDA) per ton shipped. One half of the total Performance Shares awarded is earned based on each performance category. Earned awards will be paid 60% in cash and 40% in Company common stock. In accordance with APB Opinion No. 25, the Company recorded compensation expense of \$0.8 million and \$1.4 million in the three and nine months ended September 30, 2005, respectively, based on the quoted market price of the Company's stock at September 30, 2005. These expenses are classified as selling, general and administrative expenses.

Also in conjunction with the LTIP, shares of restricted common stock were awarded to non-employee directors with the shares vesting in equal parts over three years beginning April 28, 2005. The Company recorded compensation expense of \$16,000 and \$27,000 in the three and nine months ended September 30, 2005, which was classified as selling, general and administrative expenses.

The following table illustrates the effect on net income and earnings per share as if the Black-Scholes fair value method described in SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended, had been applied to the Company's stock-based compensation plans.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
	(In thousands, except per share amounts)			
Net income, as reported	\$ 20,240	\$ 50,343	\$ 77,015	\$ 71,888
Add: total stock-based compensation expense included in reported net income, net of related tax effects	528		898	
Deduct: total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(600)	(153)	(1,118)	(497)
Pro forma net income	\$ 20,168	\$ 50,190	\$ 76,795	\$ 71,391
Income per share:				
Basic as reported	\$ 0.57	\$ 1.89	\$ 2.17	\$ 2.70
Basic pro forma	\$ 0.57	\$ 1.88	\$ 2.17	\$ 2.69
Diluted as reported	\$ 0.57	\$ 1.87	\$ 2.15	\$ 2.69
Diluted pro forma	\$ 0.56	\$ 1.86	\$ 2.15	\$ 2.67

3. Inventories

Inventories are stated at the lower of manufacturing cost or market value with manufacturing cost determined under the average cost method. The components of inventories are as follows:

	September 30, 2005	December 31, 2004
	(In thousands)	
Raw materials	\$ 34,906	\$ 20,168
Semi-finished product	202,088	136,362
Finished product	78,137	50,073
Stores and operating supplies	31,567	28,407
Total inventories	\$ 346,698	\$ 235,010

Semi-finished product includes Company manufactured and purchased steel plate and coil that will be converted into finished welded pipe or structural tubing product by the Company.

4. Comprehensive Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
	(In thousands)		(In thousands)	
Net income	\$ 20,240	\$ 50,343	\$ 77,015	\$ 71,888
Minimum pension liability	87		87	
Foreign currency translation adjustment	2,367	1,417	1,870	692
Comprehensive income	\$ 22,694	\$ 51,760	\$ 78,972	\$ 72,580

5. Debt, Financing Arrangements and Liquidity

Debt balances are as follows:

	September 30, 2005	December 31, 2004
	(In thousands)	
10% First Mortgage Notes due 2009	\$ 303,000	\$ 305,000
Less unamortized discount on 10% Notes	(2,339)	(2,721)
OFP Term Loan	6,577	8,500
CPC Mortgage Loan	3,523	3,549
Camrose Revolving Credit Facility		1,830
Total debt outstanding	310,761	316,158
Less current portion of OFP Term Loan	(2,000)	(2,423)
Less current portion of CPC Mortgage Loan	(41)	(36)
Non-current maturity of long-term debt	\$ 308,720	\$ 313,699

On July 15, 2002, the Company issued \$305.0 million of 10% First Mortgage Notes due 2009 (10% Notes) at a discount of 98.772% and an interest rate of 10.0%. Interest is payable on January 15 and July 15 of each year. The 10% Notes are secured by a lien on substantially all of the property, plant and equipment, and certain other assets of the Company (exclusive of CPC and OFP), excluding accounts receivable,

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inventory, and certain other assets. The Indenture under which the 10% Notes were issued contains restrictions (except for CPC and OFP) on new indebtedness and various types of disbursements, including dividends, based on the cumulative amount of the Company's net income, as defined. New CF&I and CF&I (collectively, the Guarantors) guarantee the obligations of the 10% Notes, and those guarantees are secured by a lien on substantially all of the property, plant and equipment and certain other assets of the Guarantors, excluding accounts receivable, inventory, and certain other assets. At any time on or after July 15, 2006, the 10% Notes will be redeemable at the option of the Company, in whole or in part at a set range of redemption prices. If redeemed during the twelve-month period beginning July 15, 2006 the price is 105% of the principal amount, plus accrued and unpaid interest and any liquidated damages, as defined. The redemption price adjusts to 102.5% and 100%, respectively, for the two subsequent twelve-month periods.

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On March 29, 2000, OFP entered into a seven-year \$14.0 million loan agreement for the purchase of certain processing assets and for the construction of a processing facility. Amounts outstanding under the loan agreement bear interest based on the LIBOR plus a margin ranging from 1.25% to 3.00%. The loan is secured by all the assets of OFP. The loan agreement contains various restrictive covenants including a minimum tangible net worth amount, a minimum debt service coverage ratio, and a specified amount of insurance coverage. Principal payments required on the loan are \$0.5 million per quarter but can be accelerated for excess cash flows, as defined. Excess cash flows generated in 2004 resulted in \$0.4 million of additional principal payments paid in 2005. The creditors of OFP have no recourse to the general credit of the Company. Effective January 1, 2004, the Company included the OFP loan balance in the consolidated balance sheet as a result of the adoption of FIN 46R. See Note 11 to the Consolidated Financial Statements, *Joint Venture and Adoption of FIN 46R Consolidation of Variable Interest Entities*.

On September 17, 2004, CPC entered into a ten-year loan agreement related to an undivided 50% interest as tenants in common in a warehouse under a co-tenancy agreement. CPC's share of the debt is \$3.5 million. Amounts outstanding under the loan agreement bear interest at a rate of 6.57%. The loan is secured by the warehouse and contains various restrictive covenants on CPC including minimum income and cash flow requirements, a minimum debt service coverage amount and limitations on incurring new or additional debt obligations other than as allowed by the loan agreement.

On March 29, 2005, the Company entered into a Letter of Credit Facility Agreement (*Credit Agreement*) with U.S. Bank National Association. The *Credit Agreement*, as amended, provides for a maximum borrowing of \$35.0 million for the sole purpose of issuing letters of credit and terminates on March 29, 2006. Under the *Credit Agreement*, the Company agrees to pay an issuance fee of the greater of \$100 or the face amount of a letter of credit multiplied by 0.125% and a fee, payable quarterly in arrears, at a rate of 0.50% per annum of the average aggregate undrawn face amount of all outstanding letters of credit during the preceding calendar quarter. The *Credit Agreement* contains certain customary covenants for credit facilities of this type, such as provisions regarding compliance with laws, taxes, notice to issuers and financial information and will be secured by restricted cash. As of September 30, 2005, the Company had \$22.5 million of restricted cash as collateral supporting \$21.4 million of letters of credit associated with the *Credit Agreement*.

Camrose maintains a CDN \$15.0 million revolving credit facility with a Canadian bank, the proceeds of which may be used for working capital and general business purposes of Camrose. Amounts under the facility bear interest based on the Canadian prime rate. The facility is collateralized by substantially all of the assets of Camrose, and borrowings under this facility are limited to an amount equal to the sum of the product of specified advance rates and Camrose's eligible trade accounts receivable and inventories. The credit facility contains various restrictive covenants including a minimum tangible net worth amount. This facility expires in September 2006. At September 30, 2005, there were no restricted amounts for outstanding letters of credit. The average interest rates for the facility were 4.3% for both the three and nine month periods ended September 30, 2005. Camrose pays annual commitment fees of up to 0.25% of the unused portion of the credit line.

As of September 30, 2005, principal payments on debt are due as follows (in thousands):

2005	\$ 510
2006	2,042
2007	4,122
2008	48
2009	303,051
2010	54
2011 and thereafter	3,273
	\$ 313,100

6. Income Taxes

The effective income tax expense rate was 28.2% and 35.2% for the three and nine months ended September 30, 2005, respectively, as compared to a tax expense rate of 2.9% and 2.0% for the three and nine months ended September 30, 2004, respectively. The effective income tax rate for the three and nine months ended September 30, 2005 varied from the combined state and federal statutory rate principally because the Company reversed a portion of the valuation allowance, established in 2003, for certain state net operating loss carry-forwards and state tax credits. The effective income tax rate for the three and nine months ended September 30, 2004 varied from the combined state and federal statutory rate principally because the Company reversed a portion of the valuation allowance, established in 2003, for certain federal and state net operating loss carry-forwards, state tax credits and alternative minimum tax credits.

SFAS No. 109, *Accounting for Income Taxes*, requires that tax benefits for federal and state net operating loss carry-forwards, state tax credits, and alternative minimum tax credits each be recorded as an asset to the extent that management assesses the utilization of such assets to

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be more likely than not ; otherwise, a valuation allowance is required to be recorded. Based on this guidance, the Company reduced the valuation allowance by \$3.4 million for both the three and nine months ended September 30, 2005. A consistent track record of earnings in prior quarters, and an update of expected future earnings tied to changes in product lines announced in the quarter ended September 30, 2005, created less uncertainty regarding the realization of these state deferred tax assets. For the three and nine months ended September 30, 2004,

Shareholder sign above Date

Co-holder (if any) sign above Date

SCHMITT INDUSTRIES, INC.

THIS [WHITE] PROXY CARD IS SOLICITED BY THE BOARD OF DIRECTORS

Should the undersigned be present and elect to vote at the Annual Meeting or at any adjournment thereof and after notification to the Corporate Secretary of Schmitt Industries, Inc. at the Annual Meeting of the shareholder's decision to terminate this proxy, then the power of said attorneys and proxies shall be deemed terminated and of no further force and effect. This [WHITE] proxy may also be revoked by sending written notice to the Corporate Secretary of Schmitt Industries, Inc. at the address set forth on the Notice of Annual Meeting of Shareholders, or by the filing of a later proxy prior to a vote being taken on a particular proposal at the Annual Meeting.

The above signed acknowledges receipt from Schmitt Industries, Inc. prior to the execution of this proxy of Notice of the Meeting, Proxy Statement dated [], 2018 and the Annual Report to the Shareholders on Form 10-K.

Please sign exactly as your name appears on this card. When signing as attorney, executor, administrator, trustee or guardian, please give your full title. If shares are held jointly, each holder may sign but only one signature is required.

Important Notice Regarding the Availability of Proxy Materials

For the Shareholder Meeting to be Held on October 12, 2018

The Proxy Statement and the Annual Report to Shareholders on Form 10-K are available at:

www.schmitt-ind.com and www.viewproxy.com/schmittindustries/2018

VOTE BY INTERNET OR TELEPHONE

24 Hours a Day 7 Days a Week

Your telephone or internet vote authorizes the named attorneys-in-fact to vote your shares in the same manner as if you marked, signed and returned the [WHITE] proxy card. If you have submitted your proxy by telephone or the Internet, there is no need for you to mail back your proxy card. Telephone and Internet voting facilities will close at

11:59 p.m. Eastern Time on [], 2018.

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Detach the WHITE proxy card above

Return the WHITE proxy card in the postage-paid envelope provided