

OLYMPIC STEEL INC  
Form 10-Q  
November 08, 2012

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2012

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-23320

OLYMPIC STEEL, INC.  
(Exact name of registrant as specified in its charter)

|  |                                      |
|--|--------------------------------------|
| Ohio   | 34-1245650                           |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 5096 Richmond Road, Bedford Heights, Ohio                      | 44146                                |
| (Address of principal executive offices)                       | (Zip Code)                           |

Registrant's telephone number, including area code (216) 292-3800

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes (X) No ( )

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes (X) No ( )

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or

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

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

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

| Class                           | Outstanding as of November 8,<br>2012 |
|---------------------------------|---------------------------------------|
| Common stock, without par value | 10,917,840                            |

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## Part I. FINANCIAL INFORMATION

## Item 1. Financial Statements

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

|   | September 30,<br>2012<br>(unaudited) | December 31,<br>2011<br>(audited) |
|---|--------------------------------------|-----------------------------------|
| <b>Assets</b>                                     |                                      |                                   |
| Cash and cash equivalents                         | \$ 3,832                             | \$ 7,403                          |
| Accounts receivable, net                          | 152,434                              | 122,579                           |
| Inventories, net                                  | 288,698                              | 277,765                           |
| Prepaid expenses and other                        | 9,417                                | 13,112                            |
| Total current assets                              | 454,381                              | 420,859                           |
| Property and equipment, at cost                   | 345,593                              | 329,116                           |
| Accumulated depreciation                          | (146,965 )                           | (135,703 )                        |
| Net property and equipment                        | 198,628                              | 193,413                           |
| Goodwill  | 47,370                               | 47,254                            |
| Intangible assets, net                            | 35,646                               | 36,313                            |
| Other long-term assets                            | 11,603                               | 9,660                             |
| <b>Total assets</b>                               | <b>\$ 747,628</b>                    | <b>\$ 707,499</b>                 |
| <b>Liabilities</b>                                |                                      |                                   |
| Current portion of long-term debt                 | \$ 10,253                            | \$ 9,662                          |
| Accounts payable                                  | 98,754                               | 104,425                           |
| Accrued payroll                                   | 10,879                               | 11,613                            |
| Other accrued liabilities                         | 14,039                               | 13,875                            |
| Total current liabilities                         | 133,925                              | 139,575                           |
| Credit facility revolver                          | 211,015                              | 170,405                           |
| Long-term debt                                    | 56,111                               | 64,149                            |
| Other long-term liabilities                       | 11,788                               | 9,580                             |
| Deferred income taxes                             | 34,952                               | 37,214                            |
| <b>Total liabilities</b>                          | <b>447,791</b>                       | <b>420,923</b>                    |
| <b>Shareholders' Equity</b>                       |                                      |                                   |
| Preferred stock                                   | -                                    | -                                 |
| Common stock                                      | 121,905                              | 119,816                           |
| Accumulated other comprehensive loss, net of tax  | (568 )                               | -                                 |
| Retained earnings                                 | 178,500                              | 166,760                           |
| <b>Total shareholders' equity</b>                 | <b>299,837</b>                       | <b>286,576</b>                    |
| <b>Total liabilities and shareholders' equity</b> | <b>\$ 747,628</b>                    | <b>\$ 707,499</b>                 |

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)

|  | Three Months Ended<br>September 30,<br>2012<br>(unaudited) | 2011      | Nine Months Ended<br>September 30,<br>2012<br>(unaudited) | 2011      |
|--|--|-----------|---|-----------|
| Net sales  | \$342,560  | \$348,547 | \$1,091,977   | \$941,928 |
| Costs and expenses   |  |           |   |           |
| Cost of materials sold (excludes items shown separately below) | 276,504  | 281,058   | 879,060   | 750,638   |
| Warehouse and processing                                       | 21,667   | 19,471    | 63,892  | 51,432    |
| Administrative and general                                     | 16,765   | 16,461    | 52,647  | 43,339    |
| Distribution   | 8,682  | 8,080     | 26,960  | 20,427    |
| Selling  | 7,085  | 7,209     | 20,989  | 18,140    |
| Occupancy  | 2,057  | 2,297     | 6,495   | 5,790     |
| Depreciation   | 4,953  | 4,434     | 14,636  | 11,413    |
| Amortization   | 223  | 222       | 667   | 222       |
| Total costs and expenses                                       | 337,936  | 339,232   | 1,065,346   | 901,401   |
| Operating income   | 4,624  | 9,315     | 26,631  | 40,527    |
| Other (income) expense, net                                    | (51 )  | 91        | (90 )   | 91        |
| Income before interest and income taxes                        | 4,675  | 9,224     | 26,721  | 40,436    |
| Interest and other expense on debt                             | 2,120  | 2,237     | 6,411   | 3,868     |
| Income before income taxes                                     | 2,555  | 6,987     | 20,310  | 36,568    |
| Income tax provision   | 916  | 851       | 7,915   | 12,163    |
| Net income   | \$1,639  | \$6,136   | \$12,395  | \$24,405  |
| Net loss on interest rate hedge, net of tax                    | (165 )   | -         | (568 )  | -         |
| Total comprehensive income                                     | \$1,474  | \$6,136   | \$11,827  | \$24,405  |
| Earnings per share:  |  |           |   |           |
| Net income per share - basic                                   | \$0.15   | \$0.56    | \$1.13  | \$2.23    |
| Weighted average shares outstanding - basic                    | 10,961   | 10,937    | 10,958  | 10,936    |
| Net income per share - diluted                                 | \$0.15   | \$0.56    | \$1.13  | \$2.23    |
| Weighted average shares outstanding - diluted                  | 10,967   | 10,951    | 10,967  | 10,949    |

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

**Olympic Steel, Inc.**  
**Consolidated Statements of Cash Flows**  
(in thousands)

|   | Nine Months Ended<br>September 30, |             |             |
|---|------------------------------------|-------------|-------------|
|   | 2012                               | (unaudited) | 2011        |
| <b>Cash flows from (used for) operating activities:</b>                                       |                                    |             |             |
| Net income  | \$ 12,395                          | \$ 24,405   | (unaudited) |
| Adjustments to reconcile net income to net cash used for operating activities -               |                                    |             |             |
| Purchase price inventory adjustment   | -                                  | 1,017       |             |
| Depreciation and amortization   | 16,263                             | 12,050      |             |
| Loss on disposition of property and equipment   | 23                                 | 65          |             |
| Stock-based compensation  | 1,741                              | 647         |             |
| Other long-term assets  | (1,810 )                           | 1,220       |             |
| Other long-term liabilities   | 1,640                              | 5,399       |             |
|   | 30,252                             | 44,803      |             |
| <b>Changes in working capital:</b>  |                                    |             |             |
| Accounts receivable   | (29,855 )                          | (49,350 )   |             |
| Inventories   | (10,933 )                          | (41,748 )   |             |
| Income taxes receivable and deferred  | (2,262 )                           | 8,750       |             |
| Prepaid expenses and other  | 3,695                              | (5,861 )    |             |
| Accounts payable  | (2,195 )                           | 34,379      |             |
| Change in outstanding checks  | (3,476 )                           | 9,479       |             |
| Accrued payroll and other accrued liabilities   | (390 )                             | (10,240 )   |             |
|   | (45,416 )                          | (54,591 )   |             |
| Net cash used for operating activities  | (15,164 )                          | (9,788 )    |             |
| <b>Cash flows from (used for) investing activities:</b>                                       |                                    |             |             |
| Acquisition of Chicago Tube and Iron, net of cash acquired                                    | -                                  | (148,759 )  |             |
| Capital expenditures  | (20,290 )                          | (24,618 )   |             |
| Proceeds from disposition of property and equipment   | 236                                | 699         |             |
| Net cash used for investing activities  | (20,054 )                          | (172,678 )  |             |
| <b>Cash flows from (used for) financing activities:</b>                                       |                                    |             |             |
| Credit facility revolver borrowings   | 437,925                            | 444,134     |             |
| Credit facility revolver repayments   | (397,315 )                         | (324,909 )  |             |
| Principal payments under capital lease obligations  | (130 )                             | (39 )       |             |
| Term loan borrowings  | -                                  | 70,000      |             |
| Term loan repayments  | (6,562 )                           | (2,188 )    |             |
| Industrial revenue bond repayments  | (755 )                             | -           |             |
| Credit facility fees and expenses   | (1,209 )                           | (4,193 )    |             |
| Proceeds from exercise of stock options (including tax benefits) and employee stock purchases | 348                                | 34          |             |
| Dividends paid  | (655 )                             | (654 )      |             |
| Net cash from financing activities  | 31,647                             | 182,185     |             |

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Cash and cash equivalents:

|                   |          |          |
|-------------------|----------|----------|
| Net change        | (3,571 ) | (281 )   |
| Beginning balance | 7,403    | 1,492    |
| Ending balance    | \$ 3,832 | \$ 1,211 |

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

**Olympic Steel, Inc.**  
**Supplemental Disclosures of Cash Flow Information**  
(in thousands)

|  | Nine Months Ended<br>September 30, |             |
|--|------------------------------------|-------------|
|  | 2012                               | 2011        |
| Cash paid during the period            |                                    | (unaudited) |
| Interest paid                          | \$ 5,622                           | \$ 3,089    |
| Income taxes paid                      | \$ 6,170                           | \$ 8,852    |
| <br>                                   |                                    |             |
| Details of acquisition                 |                                    |             |
| Fair value of CTI assets acquired      | \$ -                               | \$ 215,817  |
| Fair value of CTI liabilities acquired | -                                  | 55,961      |
| Cash paid                              | -                                  | 159,856     |
| Less: Cash acquired                    | -                                  | 11,097      |
| Net cash paid for CTI acquisition      | \$ -                               | \$ 148,759  |

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

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

Olympic Steel, Inc.

Notes to Consolidated Financial Statements

(unaudited)

September 30, 2012

(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 2012 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, 2011. All significant intercompany transactions and balances have been eliminated in consolidation.

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

(2) Acquisition of Chicago Tube and Iron Company:

On July 1, 2011, the Company acquired all of the outstanding common shares of CTI pursuant to the terms of an Agreement and Plan of Merger dated May 18, 2011. Total cash paid, net of cash acquired, was \$148.8 million.

Pro Forma Financial Information

The following unaudited pro forma summary of financial results presents the consolidated results of operations as if the CTI acquisition had occurred on January 1, 2010, after the effect of certain adjustments, including increased depreciation expense resulting from recording fixed assets at fair value, interest expense on the acquisition debt and amortization of customer relationships, with the related tax effects. The pro forma results for the nine months ended September 30, 2011 do not include any transaction costs and other non-recurring acquisition related expenses. The pro forma results have been presented for comparative purposes only and are not indicative of what would have occurred had the acquisition been made on January 1, 2010, or of any potential results that may occur in the future.

Nine months ended  
September 30, 2011  
(Pro-forma)

(in thousands, except per share amounts)

Pro forma (unaudited):

|            |              |
|------------|--------------|
| Net sales  | \$ 1,062,435 |
| Net income | \$ 27,053    |

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|                                   |         |
|-----------------------------------|---------|
| Basic earnings per common share   | \$ 2.47 |
| Diluted earnings per common share | \$ 2.47 |

## (3) Accounts Receivable:

The Company maintained allowances for doubtful accounts and unissued credits of \$3.5 million and \$2.9 million at September 30, 2012 and December 31, 2011, 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.

## (4) Inventories:

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

As a result of the acquisition of CTI, certain of the Company's tubular and pipe products inventory is stated under the last-in, first-out (LIFO) method, which is not in excess of market. At September 30, 2012, approximately \$46.3 million, or 16.0% of consolidated inventory, was reported under the LIFO method of accounting. The cost of the remainder of CTI's inventory is determined using a weighted average first-in, first-out method.

An actual valuation of the inventory under the LIFO method is made at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management's estimates of expected year-end inventory levels and costs. Because estimates are subject to many factors beyond management's control, annual results may differ from interim results. Interim LIFO estimates are subject to a final year-end LIFO inventory valuation. The Company did not record a LIFO adjustment in its third quarter of 2012 because its full-year LIFO estimate anticipates prices and quantities to be below July 1, 2011 levels. As a result, there was no LIFO reserve at September 30, 2012.

Metal inventories consist of the following:

|                        | September 30,<br>2012 | December 31,<br>2011 |
|------------------------|-----------------------|----------------------|
| <b>(in thousands)</b>  |                       |                      |
| Unprocessed            | \$ 209,995            | \$ 207,301           |
| Processed and finished | 78,703                | 70,464               |
| <b>Totals</b>          | <b>\$ 288,698</b>     | <b>\$ 277,765</b>    |

## (5) Intangible Assets:

Intangible assets, net, consisted of the following as of September 30, 2012 and December 31, 2011:

|  | Gross Carrying<br>Amount | Accumulated<br>Amortization | Intangible<br>Assets,<br>Net |
|--|--------------------------|-----------------------------|------------------------------|
| September 30, 2012<br><br>(in thousands) |                          |                             |                              |

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|  |           |             |           |
|--|-----------|-------------|-----------|
| Customer relationships - subject to amortization | \$ 13,332 | \$ (1,111 ) | \$ 12,221 |
| Trade name - not subject to amortization         | 23,425    | -           | 23,425    |
|  | \$ 36,757 | \$ (1,111 ) | \$ 35,646 |

|  | Gross Carrying<br>Amount | Accumulated<br>Amortization | Intangible<br>Assets, Net |
|--|--------------------------|-----------------------------|---------------------------|
| December 31, 2011<br>(in thousands)              |                          |                             |                           |
| Customer relationships - subject to amortization | \$ 13,332                | \$ (444 )                   | \$ 12,888                 |
| Trade name - not subject to amortization         | 23,425                   | -                           | 23,425                    |
|  | \$ 36,757                | \$ (444 )                   | \$ 36,313                 |

The Company estimates that amortization expense for its intangible assets subject to amortization will be \$889 thousand for the year ended December 31, 2012 and \$889 thousand per year in each of the next five years.

(6) Goodwill:

The carrying amount of goodwill, by reportable segment, is as follows:

|                           | September 30,<br>2012 | December 31,<br>2011 |
|---------------------------|-----------------------|----------------------|
| (in thousands)            |                       |                      |
| Flat products             | \$ 7,083              | \$ 7,083             |
| Tubular and pipe products | 40,287                | 40,171               |
| Total                     | \$ 47,370             | \$ 47,254            |

The goodwill is not deductible for income tax purposes. The goodwill represents the excess of cost over the fair value of net tangible and intangible assets acquired. The Company paid for goodwill in conjunction with the acquisitions, as they enhance the Company's commercial opportunities by adding new product offerings to an expanded customer base and by increasing the Company's distribution footprint.

In accordance with the Accounting Standards Codification, on an annual basis, an impairment test of goodwill is performed in the fourth quarter, or more frequently if changes in circumstances or the occurrence of events indicate potential impairment. Events or changes in circumstances that could trigger an impairment review include significant nonperformance relative to the expected historical or projected future operating results, significant changes in the manner of the use of the acquired assets or the strategy for the overall business or significant negative industry or economic trends.

Due to the Company's book value exceeding the Company's market capitalization, a triggering event review of potential goodwill impairment was performed in the second quarter as of June 1, 2012. For the goodwill related to the tubular and pipe products segment, a qualitative assessment was performed. For the Company's reportable units within the flat products segment, a discounted cash flow analysis was performed, which contains significant unobservable inputs, based upon average earnings before interest, taxes, depreciation and amortization and cash flow multiples. In all cases, the fair values of the entities were in excess of the carrying values of the entities and there were no indications of impairment.

The Company concluded there were no new triggering events in the third quarter that would have required a goodwill impairment test as of September 30, 2012.

(7) Investments in Joint Ventures:

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The Company and the United States Steel Corporation each own 50% of Olympic Laser Processing (OLP), a company that produced laser welded sheet steel blanks for the automotive industry. OLP ceased operations in 2006. In December 2006, the Company advanced \$3.2 million to OLP to cover a loan guarantee.

In May 2012, the real estate associated with OLP was sold, resulting in a pre-tax loss on sale to the Company of \$9 thousand. The Company expects to finalize all of the transactions related to the sale of the real estate and to dissolve OLP in the fourth quarter of 2012.

As of December 31, 2011, the investment in and advance to OLP was valued at \$1.6 million on the Company's Consolidated Balance Sheet. The investment in OLP was determined using Level 2 inputs. The valuation was based upon sales comparisons of real estate properties that were similar in type and geography.

(8) Debt:

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

| (in thousands)  | September 30,<br>2012 | December 31,<br>2011 |
|---|-----------------------|----------------------|
| Asset-based revolving credit facility due June 30, 2016 | \$ 211,015            | \$ 170,405           |
| Term loan due June 30, 2016                             | 59,792                | 66,354               |
| Industrial revenue bond due April 1, 2018               | 5,125                 | 5,880                |
| Capital lease   | 1,447                 | 1,577                |
| Total debt  | 277,379               | 244,216              |
| Less current amount                                     | (10,253 )             | (9,662 )             |
| Total long-term debt                                    | \$ 267,126            | \$ 234,554           |

On March 16, 2012, the Company amended its existing asset-based revolving credit facility. The amendment provided, among other things: (i) a reduction in the applicable margin for loans under the Company's Loan and Security Agreement; (ii) additional revolving commitments to the borrowers in an aggregate principal amount of \$50 million, which additional revolving commitments do not impact the borrowers' incremental facilities; and (iii) permits certain transactions among the borrowers and Metales de Olympic, S. de R.L. de C.V., an indirect subsidiary of the Company. The amended asset-based credit facility (the ABL Credit Facility) consists of a revolving credit line of \$315 million and a \$64 million term loan, with monthly principal payments. At September 30, 2012, the term loan balance was \$59.8 million. Revolver borrowings are limited to the lesser of a borrowing base, comprised of eligible receivables and inventories, or \$315 million in the aggregate. The ABL Credit Facility matures on June 30, 2016.

The ABL Credit Facility requires the Company to comply with various covenants, the most significant of which include: (i) until maturity of the ABL Credit Facility, if any commitments or obligations are outstanding and the Company's availability is less than the greater of \$20 million, 12.5% of the aggregate amount of revolver commitments (\$26 million at September 30, 2012), or 60% of the principal balance of the term loan then outstanding (\$36 million at September 30, 2012), then the Company must maintain a ratio of EBITDA minus certain capital expenditures and cash taxes paid to fixed charges of at least 1.10 to 1.00 for the most recent twelve fiscal month period; (ii) limitations on dividend payments; (iii) restrictions on additional indebtedness; and (iv) limitations on investments and joint ventures. Effective with the March 16, 2012 amendment, 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 0.50% or the London Interbank Offered Rate (LIBOR) plus a premium ranging from 1.50% to 2.00%. The interest rate under the term loan is based on the agent's base rate plus a premium ranging from 0.25% to 0.75% or LIBOR plus a premium ranging from 1.75% to 2.25%.

As of September 30, 2012, the Company was in compliance with its covenants and had approximately \$75 million of availability under the ABL Credit Facility.

In June 2012, the Company entered into a forward starting fixed rate interest rate hedge commencing July 2013 in order to eliminate the variability of cash interest payments on \$53 million of the outstanding LIBOR based borrowings under the ABL Credit Facility. The hedge matures on June 1, 2016 and is reduced monthly by the principal payments on the term loan. 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

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interest rate hedge agreement, the Company anticipates performance by the counterparties.

As of September 30, 2012, \$5.0 million of bank financing fees were included in “Prepaid expenses and other” and “Other long-term assets” on the accompanying Consolidated Balance Sheet. This includes \$1.2 million of financing fees paid for the March 16, 2012 amendment. The financing fees are being amortized over the remaining term of the ABL Credit Facility.

As part of the CTI acquisition, the Company assumed approximately \$5.9 million of Industrial Revenue Bond indebtedness issued through the Stanly County, North Carolina Industrial Revenue and Pollution Control Authority (IRB). As of September 30, 2012 \$5.1 million was outstanding on the IRB. The bond matures in April 2018, with the option to provide principal payments annually on April 1st. Interest is payable monthly, with a variable rate that resets weekly. As 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, 2012 was 0.29% for the IRB debt.

The Company entered into an interest rate swap agreement to reduce the impact of changes in interest rates on the above IRB. At September 30, 2012, the effect of the swap agreement on the bond was to fix the rate at 3.46%. The swap agreement matures April 2018, but is reduced annually by the amount of the optional principal payments on the bond. Although the Company is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreement, the Company anticipates performance by the counterparties.

(9) Derivative Instruments:

Nickel swaps

During 2012 and 2011, the Company entered into nickel swaps indexed to the London Metal Exchange (LME) price of nickel with third-party brokers. The nickel 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 nickel. The nickel swaps vary in length from nine to 21 months and are settled with the broker at maturity. The nickel swaps settle on a monthly basis from December 2012 through November 2013. The economic benefit or loss arising from the changes in fair value of the swaps is contractually passed through to the customer. The primary risk associated with the nickel swaps is the ability of 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 nickel swap.

In October 2011, MF Global UK Limited (MF Global UK), a United Kingdom based broker-dealer, was placed into the United Kingdom's administration process (a process similar to bankruptcy proceedings in the United States) by the Financial Services Authority following the Chapter 11 bankruptcy filing of its U.S. parent, MF Global Holdings Ltd. The Company had used MF Global UK as one of its third-party brokers for nickel swaps. All of the Company's open hedges with MF Global UK were closed effective November 1, 2011, and the Company does not believe it has a material obligation to MF Global UK as of September 30, 2012. However, bankruptcy and administration processes are uncertain and the results could change and the Company's financial statements may be materially impacted in the future.

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 nickel and embedded customer derivative instruments are included in "Cost of materials sold" in the Consolidated Statement of Comprehensive Income. We recognize derivative positions with both the customer and the third party for the derivatives and we classify cash settlement amounts associated with them as part of "Cost of materials sold" in the Consolidated Statements of Comprehensive Income. The periodic changes in fair value of the interest rate swap are included in "Other income and expense, net" in the Consolidated Statement of Comprehensive Income. 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.

The embedded customer derivatives are included in "Accounts receivable, net", and the nickel and interest rate swaps are included in "Other accrued liabilities" and "Other long-term liabilities" on the Consolidated Balance Sheets at

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September 30, 2012 and December 31, 2011.

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### 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 April 2018, the same time as the IRB, but is reduced annually by the amount of the principal payments on the IRB. Although the Company is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreement, the Company anticipates performance by the counterparties. The interest rate swap is not treated as a hedging instrument for accounting purposes.

### Fixed rate interest rate hedge

In June 2012, the Company entered into a forward starting fixed rate interest rate hedge commencing July 2013 in order to eliminate the variability of cash interest payments on \$53 million of the outstanding LIBOR-based borrowings under the ABL Credit Facility. The hedge matures on June 1, 2016 and is reduced monthly by the principal payments on the term loan. The fixed rate interest rate hedge is accounted for as a cash flow hedging instrument for accounting purposes.

The table below shows the total net gain or (loss) recognized in the Company's Consolidated Statement of Comprehensive Income of the derivatives for the three and nine months ended September 30, 2012 and 2011.

|                               | Net Gain (Loss) Recognized |         |                       |         |
|-------------------------------|----------------------------|---------|-----------------------|---------|
|                               | Three Months Ended         |         | Nine Months Ended     |         |
|                               | September 30,<br>2012      | 2011    | September 30,<br>2012 | 2011    |
| (in thousands)                |                            |         |                       |         |
| Interest rate swap            | \$7                        | \$(80)  | ) \$23                | \$(80 ) |
| Nickel swaps                  | 245                        | (973 )  | ) 16                  | 901     |
| Embedded customer derivatives | (245 )                     | 973     | (16 )                 | (901 )  |
| Total gain (loss)             | \$7                        | \$(80 ) | ) \$23                | \$(80 ) |

### (10) Fair Value of Financial Instruments:

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

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

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

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices that are not active; or other inputs that are observable or can be corroborated by

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observable market date 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, 2012, there were no transfers of financial assets between the levels in the fair value hierarchy. Following is a description of the valuation methodologies used for assets and liabilities measured at fair value as of September 30, 2012 and December 31, 2011:

Nickel swaps and embedded customer derivatives – Determined by using Level 2 inputs that include the price of nickel indexed to the LME. 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 swap and fixed rate interest rate hedge – 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)                         | Value of Items Recorded at Fair Value<br>As of September 30, 2012 |                |            |                |
|--|---|----------------|------------|----------------|
|  | Level 1   | Level 2        | Level 3    | Total          |
| <b>Liabilities:</b>                    |   |                |            |                |
| Embedded customer derivatives          | -   | 16             | -          | 16             |
| Nickel swaps                           | -   | 39             | -          | 39             |
| Interest rate swap                     | -   | 468            | -          | 468            |
| Fixed interest rate hedge              | -   | 923            | -          | 923            |
| <b>Total liabilities at fair value</b> | <b>\$-</b>  | <b>\$1,446</b> | <b>\$-</b> | <b>\$1,446</b> |

| (in thousands)                                      | Value of Items Not Recorded at Fair Value<br>As of September 30, 2012 |                  |            |                  |
|---|---|------------------|------------|------------------|
|   | Level 1   | Level 2          | Level 3    | Total            |
| <b>Liabilities:</b>                                 |   |                  |            |                  |
| Debt  |   |                  |            |                  |
| IRB   | \$5,125   | \$-              | \$-        | \$5,125          |
| Term loan   | -   | 59,792           | -          | 59,792           |
| Revolver  | -   | 211,015          | -          | 211,015          |
| <b>Total liabilities not recorded at fair value</b> | <b>\$5,125</b>  | <b>\$270,807</b> | <b>\$-</b> | <b>\$275,932</b> |

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

| (in thousands)                | Value of Items Recorded at Fair Value<br>As of December 31, 2011 |         |         |       |
|-------------------------------|--|---------|---------|-------|
|                               | Level 1  | Level 2 | Level 3 | Total |
| <b>Assets:</b>                |  |         |         |       |
| Embedded customer derivatives | \$-  | \$55    | \$-     | \$55  |
| <b>Liabilities:</b>           |  |         |         |       |

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|                                 |     |       |     |       |
|---------------------------------|-----|-------|-----|-------|
| Nickel swaps                    | -   | 55    | -   | 55    |
| Interest rate swap              | -   | 492   | -   | 492   |
| Total liabilities at fair value | \$- | \$547 | \$- | \$547 |

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| (in thousands)                               | Value of Items Not Recorded at Fair Value<br>As of December 31, 2011 |           |         |           |
|--|--|-----------|---------|-----------|
|  | Level 1  | Level 2   | Level 3 | Total     |
| <b>Liabilities:</b>                          |  |           |         |           |
| <b>Debt</b>                                  |  |           |         |           |
| IRB  | \$5,880  | \$-       | \$-     | \$5,880   |
| Term loan                                    | -  | 66,354    | -       | 66,354    |
| Revolver                                     | -  | 170,405   | -       | 170,405   |
| Total liabilities not recorded at fair value | \$5,880  | \$236,759 | \$-     | \$242,639 |

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 \$5.1 million and \$5.9 million, respectively, at both September 30, 2012 and December 31, 2011.

The fair values of the revolver and term loan are determined using Level 2 inputs. The carrying values of the revolver and the term loan were \$211.0 million and \$59.8 million, respectively, at September 30, 2012. The carrying value of the revolver and the term loan were \$170.4 million and \$66.4 million, respectively, at December 31, 2011. Because the revolver and term loan were amended in 2012, refinanced in 2011, and bear interest at variable interest rates, management believes that the amounts are carried at fair value at September 30, 2012 and December 31, 2011.

#### (11) Accumulated Other Comprehensive Loss:

In June 2012, the Company entered into a forward starting fixed rate interest rate hedge commencing July 2013 in order to eliminate the variability of cash interest payments on \$53 million of the outstanding LIBOR based borrowings under the ABL Credit Facility. The hedge matures on June 1, 2016 and is reduced monthly by the principal payments on the term loan. The fixed rate interest rate hedge is accounted for as a cash flow hedging instrument for accounting purposes. The fair value of the interest rate hedge of \$923 thousand, net of tax of \$355 thousand is included in “Accumulated other comprehensive loss” on the Consolidated Balance Sheets at September 30, 2012.

#### (12) Equity Plans:

##### Stock Options

The following table summarizes stock option activity during the nine months ended September 30, 2012:

|                                  | Number of Options | Weighted Average Exercise Price | Remaining Contractual Term (years) | Weighted Average Remaining Contractual Term (years) |  |
|----------------------------------|-------------------|---------------------------------|------------------------------------|---|--|
|                                  |                   |                                 |                                    | Weighted Average Exercise Price                     | Aggregate Intrinsic Value (in thousands) |
| Outstanding at December 31, 2011 | 46,007            | \$ 20.90                        |                                    |   |  |
| Granted                          | -                 | -                               |                                    |   |  |
| Exercised                        | (2,170 )          | 4.18                            |                                    |   |  |

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|                                   |          |          |     |        |  |  |
|-----------------------------------|----------|----------|-----|--------|--|--|
| Canceled                          | (1,500 ) | 32.63    |     |        |  |  |
| Outstanding at September 30, 2012 | 42,337   | \$ 21.34 | 3.0 | \$ 152 |  |  |
| Exercisable at September 30, 2012 | 42,337   | \$ 21.34 | 3.0 | \$ 152 |  |  |

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There were 2,170 stock options exercised during the nine months ended September 30, 2012. There were no stock options exercised during the nine months ended September 30, 2011. The total intrinsic value of stock options exercised during the nine months ended September 30, 2012 was \$52 thousand. All options outstanding are vested as of September 30, 2012.

#### Restricted Stock Units and Performance Share Units

The Olympic Steel 2007 Omnibus Incentive Plan (the Plan) was approved by the Company's shareholders in 2007. The Plan authorizes the Company to grant stock options, stock appreciation rights, restricted shares, restricted share units, performance shares, and other stock- and cash-based awards to employees and Directors of, and consultants to, the Company and its affiliates. Under the Plan, 500,000 shares of common stock are available for equity grants.

On January 3, 2012 and March 1, 2011, the Compensation Committee of the Company's Board of Directors approved the grant of 1,800 restricted stock units (RSUs) to each non-employee Director. Subject to the terms of the Plan and the RSU agreement, the RSUs vest after one year of service (from the date of grant). The RSUs are not converted into shares of common stock until the director either resigns or is terminated from the Board of Directors.

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 \$25.55 and \$26.91 for the grants on January 3, 2012 and March 1, 2011, respectively.

In 2011, the Compensation Committee for the Company's Board of Directors approved changes to the Senior Management Compensation Program to include an equity component in order to encourage more ownership of Common Stock by senior management. Starting in 2011, the Senior Management Compensation Program imposed stock ownership requirements upon the participants. Beginning in 2011, 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 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, 2012, the Company matched 7,250 shares. 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 executive's death or disability or upon a change in control of the Company.

In recognition of their performance and dedicated years of service, on December 31, 2011, the Compensation Committee of the Board of Directors granted 81,475 RSUs to Messrs. Michael D. Siegal, Chairman and Chief Executive Officer, David A. Wolfort, President and Chief Operating Officer, and Richard T. Marabito, Chief Financial Officer and Treasurer. 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 \$23.32 on December 31, 2011. The RSUs vest in five years. Except in limited circumstances, the RSUs will not convert into shares of Common Stock until the retirements of Messrs. Siegal, Wolfort and Marabito, respectively. These RSUs are not a part of the 2011 Senior Management Compensation Program discussed above.



Stock-based compensation expense recognized on RSUs for the three and nine months ended September 30, 2012 and 2011, respectively, is summarized in the following table:

|                                       | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |         |
|---------------------------------------|-------------------------------------|---------|------------------------------------|---------|
|                                       | 2012                                | 2011    | 2012                               | 2011    |
| (in thousands, except per share data) |                                     |         |                                    |         |
| RSU expense before taxes              | \$ 326                              | \$ 135  | \$ 878                             | \$ 351  |
| RSU expense after taxes               | \$ 209                              | \$ 118  | \$ 536                             | \$ 234  |
| Impact per basic share                | \$ 0.02                             | \$ 0.01 | \$ 0.05                            | \$ 0.02 |
| Impact per diluted share              | \$ 0.02                             | \$ 0.01 | \$ 0.05                            | \$ 0.02 |

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

The following table summarizes the activity related to RSUs for the nine months ended September 30, 2012:

|                                   | Number of<br>Shares | Weighted<br>Average<br>Granted Price | Aggregate<br>Intrinsic<br>Value<br>(in<br>thousands) |
|-----------------------------------|---------------------|--------------------------------------|--|
| Outstanding at December 31, 2011  | 147,603             | \$ 27.16                             |  |
| Granted                           | 40,368              | 23.97                                |  |
| Converted into shares             | (375 )              | 22.68                                |  |
| Forfeited                         | (1,684 )            | 25.96                                |  |
| Outstanding at September 30, 2012 | 185,912             | \$ 26.49                             | -  |
| Vested at September 30, 2012      | 123,930             | \$ 25.08                             | -  |

During the nine months ended September 30, 2012, 375 RSUs were converted into shares. No RSUs were converted into shares during the nine months ended September 30, 2011.

### (13) Capital Lease:

The Company leases a warehouse in Streetsboro, Ohio under a capital lease agreement. The Company has signed a purchase agreement to purchase the facility at the end of the lease for \$1.3 million. The capital lease obligation is included in “Current portion of short-term debt” on the accompanying Consolidated Balance Sheet.

The capital lease obligation is as follows:

|                                | September 30,<br>2012 | December 31,<br>2011 |
|--------------------------------|-----------------------|----------------------|
| (in thousands)                 |                       |                      |
| Total capital lease obligation | \$ 1,449              | \$ 1,587             |
| Less: interest                 | (2 )                  | (10 )                |
| Capital lease obligation       | 1,447                 | 1,577                |
| Less: current                  | (1,447 )              | (157 )               |
| Long term capital lease        | \$ -                  | \$ 1,420             |

(14) Income Taxes:

For the three months ended September 30, 2012, the Company recorded an income tax provision of \$916 thousand, or 35.9% of income before income taxes, compared to \$851 thousand, or 12.2% of income before income taxes, for the three months ended September 30, 2011.

For the nine months ended September 30, 2012, the Company recorded an income tax provision of \$7.9 million, or 39.0% of income before income taxes, compared to \$12.2 million, or 33.3% of income before income taxes, for the nine months ended September 30, 2011.

The lower effective tax rate in 2011 was mainly due to changes in unrecognized tax benefits due to a lapsing of the statute of limitations.

**(15) 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:

|  | Three Months Ended<br>September 30,<br>2012 | Nine Months Ended<br>September 30,<br>2012 | Three Months Ended<br>September 30,<br>2011 | Nine Months Ended<br>September 30,<br>2011 |
|--|---|--|---|--|
| (in thousands, except per share data)                          |   |  |   |  |
| Weighted average basic shares outstanding                      | 10,961                                      | 10,937                                     | 10,958                                      | 10,936                                     |
| Assumed exercise of stock options and issuance of stock awards | 6   | 14   | 9   | 13   |
| Weighted average diluted shares outstanding                    | 10,967                                      | 10,951                                     | 10,967                                      | 10,949                                     |
| Net income   | \$1,639                                     | \$6,136                                    | \$12,395                                    | \$24,405                                   |
| Basic earnings per share                                       | \$0.15                                      | \$0.56                                     | \$1.13                                      | \$2.23                                     |
| Diluted earnings per share                                     | \$0.15                                      | \$0.56                                     | \$1.13                                      | \$2.23                                     |
| Anti-dilutive securities outstanding                           | 190   | 118  | 189   | 118  |

**(16) Segment Information:**

Since the July 1, 2011 acquisition of CTI, the Company operates in two reportable segments, flat products and tubular and pipe products. The following table summarizes financial information regarding segments:

|                           | Three Months Ended<br>September 30,<br>2012 | Nine Months Ended<br>September 30,<br>2012 | Three Months Ended<br>September 30,<br>2011 | Nine Months Ended<br>September 30,<br>2011 |
|---------------------------|---|--|---|--|
| (in thousands)            |   |  |   |  |
| Net sales                 |   |  |   |  |
| Flat products             | \$279,075                                   | \$287,137                                  | \$903,591                                   | \$880,518                                  |
| Tubular and pipe products | 63,485                                      | 61,410                                     | 188,386                                     | 61,410                                     |
| Total net sales           | \$342,560                                   | \$348,547                                  | \$1,091,977                                 | \$941,928                                  |
| Operating income          |   |  |   |  |
| Flat products             | \$632                                       | \$5,762                                    | \$11,750                                    | \$36,974                                   |
| Tubular and pipe products | 3,992                                       | 3,553                                      | 14,881                                      | 3,553                                      |
| Total operating income    | \$4,624                                     | \$9,315                                    | \$26,631                                    | \$40,527                                   |



| (in thousands)                      | Three Months Ended<br>September 30, |                      | Nine Months Ended<br>September 30, |          |
|-------------------------------------|-------------------------------------|----------------------|------------------------------------|----------|
|                                     | 2012                                | 2011                 | 2012                               | 2011     |
| Depreciation and amortization       |                                     |                      |                                    |          |
| Flat products                       | \$3,969                             | \$3,281              | \$11,791                           | \$10,260 |
| Tubular and pipe products           | 1,207                               | 1,375                | 3,512                              | 1,375    |
| Total depreciation and amortization | \$5,176                             | \$4,656              | \$15,303                           | \$11,635 |
| Capital expenditures                |                                     |                      |                                    |          |
| Flat products                       | \$3,983                             | \$8,018              | \$14,715                           | \$24,434 |
| Tubular and pipe products           | 624                                 | 184                  | 5,575                              | 184      |
| Total capital expenditures          | \$4,607                             | \$8,202              | \$20,290                           | \$24,618 |
| (in thousands)                      | September 30,<br>2012               | December 31,<br>2011 |                                    |          |
| Total assets                        |                                     |                      |                                    |          |
| Flat products                       | \$524,983                           | \$494,179            |                                    |          |
| Tubular and pipe products           | 222,645                             | 213,320              |                                    |          |
| Total assets                        | \$747,628                           | \$707,499            |                                    |          |

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

The Company sells certain products internationally, primarily in North, Central and South America. International sales have been immaterial to the consolidated financial results and to the individual segment's results.

#### (17) Recently Issued Accounting Updates:

In July 2012, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2012-02, "Testing Indefinite-Lived Intangible Assets for Impairment." This ASU intends to align impairment testing guidance among long-lived asset categories. This ASU allows the assessment based on qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired prior to determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other than Goodwill. The provisions of this ASU will be applied to the interim and annual tests performed for fiscal years beginning after September 15, 2012. Early application is permitted. The Company does not expect ASU2012-02 will have a material impact on its 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, 2011. 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, 2011. 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," "potential," 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 and pricing of metal, industry shipping and inventory levels and rapid fluctuations in customer demand and metal pricing;
  - the cyclical and volatility within the metals industry;
- the ability of our customers (especially those that may be highly leveraged, and those with inadequate liquidity) to maintain their credit availability;
- the success of our new facility startups in Gary, Indiana; Mount Sterling, Kentucky; Monterrey, Mexico; Roseville, Minnesota; Kansas City, Missouri; and Streetsboro, Ohio;
- the ability to successfully integrate the newly leased locations or newly acquired businesses into our operations and achieve expected results;
  - equipment installation delays or malfunctions, including the Streetsboro, Ohio facility start up;
- the ability to comply with the terms of our asset-based credit facility and to make the required term loan payments;
- the ability of our customers and third parties to honor their agreements related to derivative instruments, including the outcome of the MF Global UK Limited administration process;
  - customer, supplier and competitor consolidation, bankruptcy or insolvency;
- reduced production schedules, layoffs or work stoppages by our own or our suppliers' or customers' personnel;
  - the availability and costs of transportation and logistical services;
- 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 strategic efforts and initiatives to increase sales volumes, maintain or improve working capital turnover and free cash flows, improve inventory turnover and improve our customer service;

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- the timing and outcome of inventory lower of cost or market adjustments;

- 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;
- the recently enacted federal healthcare legislation's impact on the healthcare benefits required to be provided by us and the impact of such legislation on our compensation and administrative costs;
- 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, 2011.

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 metal processing and distribution services for a wide range of customers. Our primary focus is on the direct sale and distribution of large volumes of processed carbon, aluminum and stainless flat-rolled sheet, coil and plate products. Commencing with the July 1, 2011 acquisition of Chicago Tube and Iron, or CTI, we also 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 greater gross profit and higher margins. Accordingly, our overall gross profit is affected by, among other things, product mix, the amount of processing performed, the demand for and availability of metal, volatility in selling prices and material purchase costs. We also perform toll processing of customer-owned metal. We sell certain products internationally, primarily in North, Central and South America. International sales have been immaterial to our consolidated financial results.

Our results of operations are affected by numerous external factors including, but not limited to: general and global business, economic, financial, banking and political conditions; competition; metal pricing, demand and availability; energy prices; pricing and availability of raw materials used in the production of metals; inventory held in the supply chain; customer demand for metal; customers' ability to manage their credit line availability; and layoffs or work stoppages by our own, our suppliers' or our customers' personnel. The metals industry also continues to be affected by the global consolidation of our suppliers, competitors and end-use customers.

Like many other service centers, we maintain substantial inventories of metal to accommodate the short lead times and just-in-time delivery requirements of our customers. Accordingly, we purchase metal in an effort to maintain our inventory at levels that we believe to be appropriate to satisfy the anticipated needs of our customers based upon customer forecasts, historic buying practices, supply agreements with customers and market conditions. Our commitments to purchase metal are generally at prevailing market prices in effect at the time we place our orders. When metal prices increase, competitive conditions will influence how much of the price increase we can pass on to our customers. To the extent we are unable to pass on future price increases in our raw materials to our customers, the net sales and profitability of our business could be adversely affected. When metal prices decline, customer demands for lower prices and our competitors' responses to those demands could result in lower sale prices and, consequently, lower margins as we use existing metal inventory.



At September 30, 2012, we employed approximately 1,850 people. Approximately 350 of the hourly plant personnel are represented by nine separate collective bargaining units. The table below shows the expiration dates of the collective bargaining agreements.

| Facility                     | Expiration date    |
|------------------------------|--------------------|
| Detroit, Michigan            | August 31, 2012    |
| Milan, Illinois              | August 12, 2013    |
| St. Paul, Minnesota          | May 25, 2013       |
| Duluth, 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     |

We are in the process of finalizing the negotiations on the collective bargaining agreement for our Detroit, Michigan operation that expired on August 31, 2012 and do not anticipate any impact to our business during this process. 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

As a result of our July 1, 2011 acquisition of CTI, we operate two reportable segments; flat products and tubular and pipe products.

#### 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 metal producers and manufacturers that require processed metal for their operations. We serve customers in most carbon steel consuming industries, including manufacturers and fabricators of transportation and material handling equipment, construction and farm machinery, storage tanks, environmental and energy generation equipment, automobiles, food service and electrical equipment, military vehicles and equipment, as well as general and plate fabricators and metals service centers. We distribute our products primarily through a direct sales force.

The flat products segment has 23 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.

#### Tubular and pipe products

The tubular and pipe products segment consists of the acquired CTI business. Through our tubular and pipe products segment, we distribute metal tubing, pipe, bar, valve and fittings and fabricate pressure parts supplied to various industrial markets. Founded in 1914, CTI operates nine facilities in the United States, primarily throughout the Midwest.



## Results of Operations

### Consolidated Operations

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

|                               | Three Months Ended<br>September 30, |                      |           |                      | Nine Months Ended<br>September 30, |                      |           |                      |
|-------------------------------|-------------------------------------|----------------------|-----------|----------------------|------------------------------------|----------------------|-----------|----------------------|
|                               | 2012                                |                      | 2011      |                      | 2012                               |                      | 2011      |                      |
|                               | \$                                  | % of<br>net<br>sales | \$        | % of<br>net<br>sales | \$                                 | % of<br>net<br>sales | \$        | % of<br>net<br>sales |
| Net sales                     | \$342,560                           | 100.0 %              | \$348,547 | 100.0 %              | \$1,091,977                        | 100.0 %              | \$941,928 | 100.0 %              |
| Cost of materials sold<br>(1) | 276,504                             | 80.7 %               | 281,058   | 80.6 %               | 879,060                            | 80.5 %               | 750,638   | 79.7 %               |
| Gross profit (2)              | 66,056                              | 19.3 %               | 67,489    | 19.4 %               | 212,917                            | 19.5 %               | 191,290   | 20.3 %               |
| Operating expenses (3)        | 61,432                              | 17.9 %               | 58,174    | 16.7 %               | 186,286                            | 17.1 %               | 150,763   | 16.0 %               |
| Operating income              | \$4,624                             | 1.4 %                | \$9,315   | 2.7 %                | \$26,631                           | 2.4 %                | \$40,527  | 4.3 %                |

(1)Cost of materials sold includes the cost of purchased metals, inbound and internal transfer freight and external processing costs

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

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

Net sales decreased 1.7% to \$342.6 million during the three months ended September 30, 2012 from \$348.5 million during the three months ended September 30, 2011. Net sales increased 15.9% to \$1.1 billion during the nine months ended September 30, 2012 from \$941.9 million during the nine months ended September 30, 2011. The increase in sales for the nine months ended September 30, 2012 was due to the July 1, 2011 acquisition of CTI and increased flat products sales volume during the first nine months of 2012. The CTI sale increase for the first nine months of 2012 totaled \$127.0 million, accounting for 84.6% of the sales increase. We expect our sales to decrease in the fourth quarter as shipments typically decrease due to less ship days, declining production schedules by customers and the average sales price is expected to be lower in the fourth quarter compared to the third quarter of 2012. In addition, certain of our locations' shipments were negatively impacted by the hurricane in late October 2012 due to the road closings and power outages in the Eastern United States.

Cost of materials sold decreased 1.6% to \$276.5 million during the three months ended September 30, 2012 from \$281.1 million during the three months ended September 30, 2011. Cost of materials sold increased 17.1% to \$879.1 million during the first nine months of 2012 from \$750.6 million during the first nine months of 2011. The increase in cost of materials sold for the nine months ended September 30, 2012 was due to the July 1, 2011 acquisition of CTI and increased tonnage in the flat products segment during the first half of 2012.

As a percentage of net sales, gross profit decreased to 19.3% in the third quarter of 2012 compared to 19.4% in the third quarter of 2011. As a percentage of net sales, gross profit decreased to 19.5% in the first nine months of 2012

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compared to 20.3% in the first nine months of 2011. The decreases in gross margin for both the three and nine months ended September 30, 2012 were primarily due to margin pressures in the flat products segment as metals prices have continued to decline in 2012. The decline in flat products segment margins was substantially offset by the pipe and tube segment margins, which are typically higher than flat products margins and have increased year-over-year. We expect our gross profit in the fourth quarter of 2012 to continue to be pressured by declining metals prices.

Operating expenses in the third quarter of 2012 increased \$3.3 million, or 5.6%, from the third quarter of 2011. As a percentage of net sales, operating expenses increased to 17.9% for the third quarter of 2012 from 16.7% in the comparable 2011 period. During 2012, higher operating expenses were primarily attributable to the facilities expansion of the past 21 months. Operating expenses during the first nine months of 2012 increased \$35.5 million, or 23.6%, from the first nine months of 2011. As a percentage of net sales, operating expenses increased to 17.1% for the first nine months of 2012 from 16.0% in the comparable 2011 period. During the first nine months of 2012, higher operating expenses were primarily attributable to the impact of the acquisition of CTI, which accounted for \$27.5 million, or 77.5%, of the increase and the increase in operating expenses at the new facilities in the flat products segment.

Interest and other expense on debt totaled \$2.1 million for the third quarter of 2012 compared to \$2.2 million for the third quarter of 2011. Interest and other expense on debt totaled \$6.4 million for the first nine months of 2012 compared to \$3.9 million for the first nine months of 2011. Our effective borrowing rate, exclusive of deferred financing fees and commitment fees, was 2.8% for the first nine months of 2012 compared to 3.1% for the first nine months of 2011. The increase in interest and other expense on debt in 2012 was primarily attributable to the additional debt incurred for the acquisition of CTI, higher financing fee amortization and increased working capital borrowings, partially offset by the lower borrowing rate under our asset based credit facility.

For the third quarter of 2012, income before income taxes totaled \$2.6 million compared to \$7.0 million in the third quarter of 2011. For the first nine months of 2012, income before income taxes totaled \$20.3 million, compared to \$36.6 million in the first nine months of 2011. An income tax provision of 39.0% was recorded for the first nine months of 2012, compared to an income tax provision of 33.3% for the first nine months of 2011. The lower effective tax rate in 2011 was mainly due to changes in unrecognized tax benefits due to a lapsing of the statute of limitations. We expect our full year 2012 income tax provision to approximate 39.0%.

Net income for the third quarter of 2012 totaled \$1.6 million or \$0.15 per basic and diluted share, compared to \$6.1 million or \$0.56 per basic and diluted share, for the third quarter of 2011. Net income for the first nine months of 2012 totaled \$12.4 million or \$1.13 per basic and diluted share, compared to \$24.4 million or \$2.23 per basic and diluted share, for the first nine months of 2011.

## Segment Operations

### Flat products

The following table presents operating results for our flat products segment for the three and nine months ended September 30, 2012 and 2011 (dollars are shown in thousands):

|                  | Three Months Ended<br>September 30, |                      | Nine Months Ended<br>September 30, |                      |
|------------------|-------------------------------------|----------------------|------------------------------------|----------------------|
|                  | 2012                                | 2011                 | 2012                               | 2011                 |
|                  | % of<br>net<br>sales                | % of<br>net<br>sales | % of<br>net<br>sales               | % of<br>net<br>sales |
| Direct tons sold | 261,712                             | 248,978              | 835,399                            | 810,578              |
| Toll tons sold   | 18,648                              | 17,425               | 58,492                             | 58,572               |
| Total tons sold  | 280,360                             | 266,403              | 893,891                            | 869,150              |
| Net sales        | \$ 279,075                          | 100.0 %              | \$ 287,137                         | 100.0 %              |
|                  |                                     |                      | \$ 903,591                         | 100.0 %              |
|                  |                                     |                      | \$ 880,518                         | 100.0 %              |

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|                               |         |        |         |        |         |        |         |        |
|-------------------------------|---------|--------|---------|--------|---------|--------|---------|--------|
| Average selling price per ton | 995     |        | 1,078   |        | 1,011   |        | 1,013   |        |
| Cost of materials sold (1)    | 231,420 | 82.9 % | 236,116 | 82.2 % | 745,988 | 82.6 % | 705,696 | 80.1 % |
| Gross profit (2)              | 47,655  | 17.1 % | 51,021  | 17.8 % | 157,603 | 17.4 % | 174,822 | 19.9 % |
| Operating expenses (3)        | 47,023  | 16.8 % | 45,259  | 15.8 % | 145,853 | 16.1 % | 137,848 | 15.7 % |
| Operating income              | 632     | 0.2 %  | 5,762   | 2.0 %  | 11,750  | 1.3 %  | 36,974  | 4.2 %  |

(1) Cost of materials sold includes the cost of purchased metals, inbound and internal transfer freight and external processing costs

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

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

Tons sold by our flat products segment increased 5.2% to 280 thousand in the third quarter of 2012, from 266 thousand in the third quarter of 2011. Tons sold by our flat products segment increased 2.8% to 894 thousand during the nine months ended September 30, 2012 from 869 thousand during the nine months ended September 30, 2011. Toll tons sold in the third quarter of 2012 was higher than the third quarter of 2011 as we performed additional toll processing for one of our existing customers. Toll tons sold in the first nine months of 2012 remained consistent with the first nine months of 2011.

Net sales in our flat products segment decreased 2.8% to \$279.1 million in the third quarter of 2012 from \$287.1 million in the third quarter of 2011. Net sales in our flat products segment increased 2.6% to \$903.6 million during the first nine months of 2012 from \$880.5 million during the first nine months of 2011. The declining market prices for metals resulted in a 7.7% decrease of the average selling price per ton during the third quarter of 2012 compared to the third quarter of 2011. The increase in net sales for the nine months ended September 30, 2012 was a result of the increased tonnage in 2012 partially offset by the decreased average selling price per ton. We expect our flat products net sales to decrease during the fourth quarter of 2012 due to less ship days, declining production schedules by customers, and expected lower average selling prices compared to the third quarter of 2012. In addition, certain of our locations' shipments were negatively impacted by the hurricane in late October 2012 due to the road closings and power outages in the Eastern United States.

Cost of materials sold in our flat products segment decreased 2.0% to \$231.4 million during the three months ended September 30, 2012 from \$236.1 million during the three months ended September 30, 2011. Cost of materials sold was lower despite increased tonnage as the average cost per ton decreased in the third quarter of 2012 compared to the third quarter of 2011. Cost of materials sold increased 5.7% to \$746.0 million during the first nine months of 2012 from \$705.7 million during the first nine months of 2011. Cost of materials sold was higher during the nine months ended September 30, 2012 than the comparable period in 2011 as tonnage increased in 2012 and the average cost of inventory was higher entering 2012 than it was entering 2011.

As a percentage of net sales, gross profit totaled 17.1% in the third quarter of 2012 compared to 17.8% in the third quarter of 2011. During the first nine months of 2012, gross profit totaled 17.4% compared to 19.9% during the same time period last year. The decrease in gross margin during 2012 was primarily due to competitive market pressures associated with declining market prices for metals in 2012, lower gross profit in our start-up locations as we build market share and the comparative effect to a rising price market during the first half of 2011. Gross margin for the first portion of the fourth quarter of 2012 has been lower than the third quarter of 2012.

Operating expenses in the third quarter of 2012 increased \$1.8 million, or 3.9%, from the third quarter of 2011. As a percentage of net sales, operating expenses increased to 16.8% for the third quarter of 2012 from 15.8% in the comparable 2011 period. Operating expenses during the first nine months of 2012 increased \$8.0 million, or 5.8%, from the first nine months of 2011. As a percentage of net sales, operating expenses increased to 16.1% for the first nine months of 2012 from 15.7% in the comparable 2011 period. The increase in operating expenses during 2012 is a result of six new start-up locations, which are at various stages of capacity. Our Streetsboro, Ohio facility became operational in the third quarter of 2012.

Operating income for our flat products segment totaled \$632 thousand for the third quarter of 2012 compared to \$5.8 million in the comparable 2011 period. Operating income for the first nine months of 2012 totaled \$11.8 million compared to \$37.0 million in the comparable 2011 period.

## Tubular and pipe products

The following table presents operating results for our tubular and pipe products segment for the three and nine months ended September 30, 2012 and for the three months ended September 30, 2011 (dollars are shown in thousands):

|                            | Three Months Ended<br>September 30,<br>2012 |                   |            | Nine Months Ended<br>September 30, 2012 |             |                   |
|----------------------------|---|-------------------|------------|---|-------------|-------------------|
|                            | \$  | % of net<br>sales | \$         | % of net<br>sales                       | \$          | % of net<br>sales |
| Net sales                  | \$63,485                                    | 100.0             | % \$61,410 | 100.0                                   | % \$188,386 | 100.0             |
| Cost of materials sold (1) | 45,084                                      | 71.0              | % 44,942   | 73.2                                    | % 133,072   | 70.6              |
| Gross profit (2)           | 18,401                                      | 29.0              | % 16,468   | 26.8                                    | % 55,314    | 29.4              |
| Operating expenses (3)     | 14,409                                      | 22.7              | % 12,913   | 21.0                                    | % 40,433    | 21.5              |
| Operating income           | 3,992                                       | 6.3               | % 3,555    | 5.8                                     | % 14,881    | 7.9               |

2011 data includes only the 3rd quarter due to the July 1, 2011 acquisition date of CTI.

(1) Cost of materials sold includes the cost of purchased metals, inbound and internal transfer freight and external processing costs

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

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

Net sales in our tubular and pipe products segment increased 3.4% to \$63.5 million in the third quarter of 2012, from \$61.4 million in the third quarter of 2011. Net sales for the nine months ended September 30, 2012 totaled \$188.4 million, or 17.3% of consolidated net sales.

Cost of materials sold in our tubular and pipe products segment remained flat at \$45 million for the three months ended September 30, 2012 and 2011. Cost of materials sold was \$133.1 million, or 15.1% of consolidated cost of materials sold for the nine months ended September 30, 2012.

Tubular and pipe products segment gross margins are higher than our traditional flat products segment. As a percentage of net segment sales, gross profit totaled 29.0% in the third quarter of 2012 compared to 26.8% in the third quarter of 2011. As a percentage of net segment sales, gross profit totaled 29.4% for the first nine months of 2012. As part of purchase price accounting, certain CTI inventory was adjusted to its fair market value or its selling price on July 1, 2011, and then subsequently expensed to cost of goods sold. This resulted in lower 2011 third quarter tubular and pipe products segment gross margins of approximately \$1.0 million, or 1.6% of segment sales.

Operating expenses in the third quarter of 2012 increased \$1.5 million, or 11.6%, from the third quarter of 2011. As a percentage of net sales, operating expenses increased to 22.7% of net sales for the third quarter of 2012 from 21.0% of net sales in the comparable 2011 period. Operating expenses during the first nine months of 2012 totaled \$40.4 million, or 21.7% of consolidated operating expenses.

Operating income for the third quarter of 2012 totaled \$4.0 million compared to operating income of \$3.6 million in the third quarter of 2011. Operating income for the first nine months of 2012 totaled \$14.9 million.

#### 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 asset-based credit facility to fund these requirements.

#### Operating Activities

For the nine months ended September 30, 2012, we used \$15.2 million of net cash for operations, of which \$30.3 million was generated from operating activities and \$45.4 million was used for working capital.

Working capital at September 30, 2012 totaled \$320.5 million, a \$39.2 million increase from December 31, 2011. The increase was primarily attributable to a \$29.9 million increase in accounts receivable (resulting from higher sales than the slow part of the end of the year with holidays in December 2011), and a \$10.9 million increase in inventories (resulting from increased inventory purchases and slower inventory turnover).

## Investing Activities

Net cash used for investing activities was \$20.1 million during the nine months ended September 30, 2012 compared to \$172.7 million during the nine months ended September 30, 2011. On July 1, 2011, the Company acquired CTI and total cash paid, net of cash acquired, was \$148.8 million. Capital expenditures were attributable to additional processing equipment at our existing facilities and building improvements to our new facilities in Gary, Indiana and Streetsboro, Ohio, and expansion of our equipment capabilities in Chambersburg, Pennsylvania in response to customer demands. In the second half of 2012 we reduced some of our capital spending plan. We expect to spend approximately \$25 million in 2012, depending on timing of payments, for capital expenditures; primarily related to completion of our start up locations, and additional processing equipment at our existing facilities. Commencing in 2013, we anticipate our capital spending to decrease to less than our annual depreciation expense (approximately \$20 million).

We continue to successfully implement our new business systems. During the first nine months of 2012, we expensed \$653 thousand and capitalized \$363 thousand associated with the implementation of the systems. Since the project began in 2006, we have expensed \$11.4 million and capitalized \$16.9 million associated with the project.

## Financing Activities

During the first nine months of 2012, \$31.6 million of cash was provided from financing activities, which primarily consisted of borrowings under our revolver contained in our asset-based revolving credit facility (the ABL Credit Facility). During 2012, we paid \$1.2 million of bank financing fees in connection with our March 16, 2012 amendment to our ABL Credit Facility. In addition, we paid \$6.6 million of scheduled principal payments on our term loan under our ABL Credit Facility and made a voluntary \$755 thousand principal payment on our Industrial Revenue Bond indebtedness issued through the Stanly County, North Carolina Industrial Revenue and Pollution Control Authority (IRB).

Dividends paid were \$655 thousand for the nine months ended September 30, 2012 and \$654 thousand for the nine months ended September 30, 2011. In October 2012, our Board of Directors approved a regular quarterly dividend of \$0.02 per share, which will be paid on December 17, 2012 to shareholders of record as of December 3, 2012. 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 continuing determination by our Board of Directors that the payment of dividends remains in the best interest of our shareholders.

## Debt Arrangements

On March 16, 2012 we amended our existing revolver under our ABL Credit Facility. The amendment provided, among other things: (i) a reduction in the applicable margin for loans under our Loan and Security Agreement; (ii) additional revolving commitments to the borrowers in an aggregate principal amount of \$50 million, which additional revolving commitments do not impact the borrowers' incremental facilities; and (iii) certain transactions among the borrowers and Metales de Olympic, S. de R.L. de C.V., an indirect subsidiary of ours. As amended the ABL Credit Facility consists of a revolving credit line of \$315 million and a \$64 million term loan, with monthly principal payments. At September 30, 2012 the term loan balance was \$59.8 million. Revolver borrowings are limited to the lesser of a borrowing base, comprised of eligible receivables and inventories, or \$315 million in the aggregate. The ABL Credit Facility matures on July 1, 2016.

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 \$20 million, 12.5% of the aggregate amount of revolver commitments (\$26 million at September 30, 2012), or 60% of the principal balance of the term loan then outstanding (\$36 million at September 30, 2012), then we must maintain a ratio of EBITDA minus certain capital expenditures and cash taxes paid to fixed charges of at least 1.10 to 1.00 for the most recent twelve fiscal month period; (ii) limitations on dividend payments; (iii) restrictions on additional indebtedness; and (iv) limitations on investments and joint ventures. Effective with the March 16, 2012 amendment, we have the option to borrow under our revolver based on the agent's base rate plus a premium ranging from 0.00% to 0.50% or the London Interbank Offered Rate (LIBOR) plus a premium ranging from 1.50% to 2.00%. The interest rate under the term loan is based on the agent's base rate plus a premium ranging from 0.25% to 0.75% or LIBOR plus a premium ranging from 1.75% to 2.25%.

As of September 30, 2012, we were in compliance with our covenants and had approximately \$75 million of availability under the ABL Credit Facility.

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 \$53 million of the outstanding LIBOR based borrowings under the ABL credit facility. The hedge matures on June 1, 2016 and is reduced monthly by the principal payments on the term loan. The interest rate hedge fixed the rate at 1.21% plus a premium ranging from 1.75% to 2.25%. Although we are exposed to credit loss in the event of nonperformance by the other parties to the interest rate hedge agreement, we anticipate performance by the counterparties.

As of September 30, 2012, \$5.0 million of bank financing fees were included in "Prepaid expenses and other" and "Other long-term assets" on the accompanying Consolidated Balance Sheet. This includes \$1.2 million of financing fees paid for the March 16, 2012 amendment. The financing fees are being amortized over the remaining term of the credit facility.

As part of the CTI acquisition, we assumed approximately \$5.9 million of Industrial Revenue Bond indebtedness issued through the Stanly County, North Carolina Industrial Revenue and Pollution Control Authority (IRB). The bond matures in April 2018, with the option to provide principal payments annually on April 1st. Interest is payable monthly, with a variable rate that resets weekly. As security for payment of the bonds, we 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, 2012 was 0.29% for the IRB debt.

We believe that funds available under our ABL Credit Facility and lease arrangement proceeds, together with funds generated from operations, will be sufficient to provide us with the liquidity necessary to fund anticipated working capital requirements, capital expenditure requirements and our dividend payments over at least the next 12 months. In the future, we may, as part of our business strategy, acquire companies in the same or complementary lines of business, or enter into and 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.

#### 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, 2011.

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

Our principal raw materials are carbon, stainless, and aluminum, pipe and tube, flat rolled sheet, coil and plate that we typically purchase from multiple primary metal producers. The metal industry as a whole is cyclical and, at times, pricing and availability of metal 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 metal producers, new global capacity by metal producers, higher raw material costs for the producers of metal, 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 metal to accommodate the short lead times and just-in-time delivery requirements of our customers. Accordingly, we purchase metal in an effort to maintain our inventory at levels that we believe to be appropriate to satisfy the anticipated needs of our customers based upon historic buying practices, supply agreements with customers and market conditions. Our commitments to purchase metal are generally at prevailing market prices in effect at the time we place our orders. We have no long-term, fixed-price metal purchase contracts. When metal prices increase, competitive conditions will influence how much of the price increase we can pass on to our customers. To the extent we are unable to pass on future price increases in our raw materials to our customers, the net sales and profitability of our business could be adversely affected. When metal prices decline, customer demands for lower prices and our competitors' responses to those demands could result in lower sale prices and, consequently, lower margins and inventory lower of cost or market adjustments as we sell existing inventory. Significant or rapid declines in metal 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 metal prices therefore could significantly impact our net sales, gross margins, operating income and net income.

Rising prices result in higher working capital requirements for us and our customers. Some customers may not have sufficient credit lines or liquidity to absorb significant increases in the price of metal. 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 metal prices have generally adversely affected our net sales and net income, while increasing metal prices, have generally favorably affected our net sales and net income.

Approximately 8.4% of our consolidated net sales in the first nine months of 2012 were directly to automotive manufacturers or manufacturers of automotive components and parts. Historically, due to the concentration of customers in the automotive industry, our gross margins on these sales have generally been less than our margins on sales to customers in other industries.

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 metal prices and interest rate changes. During 2012 and 2011, we entered into nickel 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. Although we are exposed to credit loss in the event of nonperformance by the other parties to the nickel swap, we anticipate performance by the counterparties.

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In October 2011, MF Global UK Limited (MF Global UK), a United Kingdom based broker-dealer, was placed into the United Kingdom's administration process (a process similar to bankruptcy proceedings in the United States) by the Financial Services Authority following the Chapter 11 bankruptcy filing of its U.S. parent, MF Global Holdings Ltd. We had used MF Global UK as one of our third-party brokers for nickel swaps. All of our open hedges with MF Global UK were closed effective November 1, 2011, and we do not believe that we have a material obligation to MF Global as of September 30, 2012. However, bankruptcy and administration processes are uncertain and the results could change and our financial statements may be materially impacted in the future.

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. 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 \$53 million of the then outstanding LIBOR based borrowings under the ABL Credit Facility. The hedge matures on June 1, 2016 and is reduced monthly by the principal payments on the term loan. The fixed rate interest rate hedge is accounted for as a cash flow hedging instrument for accounting purposes. Although we are exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreement, we anticipate performance by the counterparties.

We assumed an interest rate swap agreement on the \$5.9 million of CTI IRB. The swap agreement matures in April 2018, but may be reduced annually by the amount of the optional principal payments on the IRB. Although we are exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreement, we anticipate performance 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, 2012, our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting that occurred during the third quarter of 2012 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

| Exhibit | Description of Document   | Reference          |
|---------|---|--------------------|
| 31.1    | Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | Filed herewith     |
| 31.2    | Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | Filed herewith     |
| 32.1    | Certification of the Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | Furnished herewith |
| 32.2    | Certification of the Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | Furnished herewith |
| 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  |                    |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

OLYMPIC STEEL, INC.  
(Registrant)

Date: November 8, 2012

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

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

EXHIBIT INDEX

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