OLYMPIC STEEL INC
Form 10-Q
August 02, 2018

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 June 30, 2018

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

For the transition period from __________ to ____________

Commission File Number 0-23320

OLYMPIC STEEL, INC.

(Exact name of registrant as specified in its charter)

Ohio (State or other jurisdiction of incorporation or organization)	34-1245650 (I.R.S.Employer Identification Number)

22901 Millcreek Boulevard, Suite 650, Highland Hills, OH	44122
(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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer ( )	Accelerated filer (X)
Non-accelerated filer ( )	Smaller reporting company ( )
(Do not check if a smaller reporting company)	Emerging growth company ( )

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ( )

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

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

Class	Outstanding as of August 2, 2018
Common stock, without par value	11,008,399

Olympic Steel, Inc.

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Part I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

Olympic Steel, Inc.

Consolidated Balance Sheets

(in thousands)

	As of June 30, 2018 (unaudited)	December 31, 2017
Assets		
Cash and cash equivalents	$5,501	$3,009
Accounts receivable, net	205,245	132,737
Inventories, net (includes LIFO debit of $3,337 as of June 30, 2018 and $5,337 as of December 31, 2017)	363,595	275,307
Prepaid expenses and other	5,273	8,333
Assets held for sale	750	750
Total current assets	580,364	420,136
Property and equipment, at cost	394,470	376,710
Accumulated depreciation	(236,962)	(229,062)
Net property and equipment	157,508	147,648
Intangible assets, net	27,766	22,980
Other long-term assets	13,318	13,394
Total assets	$778,956	$604,158
Liabilities		
Current portion of long-term debt	$-	$930
Accounts payable	127,113	84,034
Accrued payroll	15,378	11,999
Other accrued liabilities	15,543	14,184
Total current liabilities	158,034	111,147
Credit facility revolver	297,674	196,235
Other long-term liabilities	11,898	12,048
Deferred income taxes	14,562	12,145
Total liabilities	482,168	331,575
Shareholders' Equity		
Preferred stock	-	-

Common stock	130,417	129,453
Treasury stock	(132)	(337)
Retained earnings	166,503	143,467
Total shareholders' equity	296,788	272,583
Total liabilities and shareholders' equity	$778,956	$604,158

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

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Olympic Steel, Inc.

Consolidated Statements of Comprehensive Income

(in thousands, except per share data)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
	(unaudited)			
Net sales	$452,917	$356,195	$828,515	$691,088
Costs and expenses				
Cost of materials sold (excludes items shown separately below)	356,061	283,041	650,838	541,495
Warehouse and processing	23,813	21,838	47,249	45,339
Administrative and general	21,523	17,887	40,396	36,052
Distribution	13,386	10,568	25,525	20,933
Selling	7,107	6,496	14,335	13,007
Occupancy	2,297	2,191	4,852	4,501
Depreciation	4,164	4,319	8,187	8,633
Amortization	247	222	469	444
Total costs and expenses	428,598	346,562	791,851	670,404
Operating income	24,319	9,633	36,664	20,684
Other loss, net	(93)	(28)	(139)	(54)
Income before interest and income taxes	24,226	9,605	36,525	20,630
Interest and other expense on debt	2,670	1,788	4,656	3,414
Income before income taxes	21,556	7,817	31,869	17,216
Income tax provision	5,708	3,020	8,392	4,720
Net income and total comprehensive income	$15,848	$4,797	$23,477	$12,496
Earnings per share:				
Net income per share - basic	$1.39	$0.42	$2.06	$1.10
Weighted average shares outstanding - basic	11,435	11,383	11,419	11,382
Net income per share - diluted	$1.39	$0.42	$2.06	$1.10
Weighted average shares outstanding - diluted	11,435	11,390	11,419	11,387
Dividends declared per share of common stock	$0.02	$0.02	$0.04	$0.04

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

Olympic Steel, Inc.

Consolidated Statements of Cash Flows

For the Six Months Ended June 30,

(in thousands)

	2018	2017
	(unaudited)	
Cash flows from (used for) operating activities:		
Net income	$23,477	$12,496
Adjustments to reconcile net income to net cash from (used for) operating activities -		
Depreciation and amortization	8,885	9,537
Loss on disposition of property and equipment	5	6
Stock-based compensation	1,168	804
Other long-term assets	(68)	(760)
Other long-term liabilities	2,195	(672)
	35,662	21,411
Changes in working capital:		
Accounts receivable	(65,899)	(56,300)
Inventories	(73,519)	(8,214)
Prepaid expenses and other	3,391	(90)
Accounts payable	41,184	4,935
Change in outstanding checks	(5,318)	(559)
Accrued payroll and other accrued liabilities	2,616	334
	(97,545)	(59,894)
Net cash used for operating activities	(61,883)	(38,483)
Cash flows from (used for) investing activities:		
Acquisition of net assets	(21,907)	-
Capital expenditures	(13,775)	(4,469)
Proceeds from disposition of property and equipment	60	85
Net cash used for investing activities	(35,622)	(4,384)
Cash flows from (used for) financing activities:		
Credit facility revolver borrowings	285,167	221,374
Credit facility revolver repayments	(183,728)	(175,246)
Principal payment under capital lease obligation	(2)	-
Industrial revenue bond repayments	(930)	(895)
Credit facility fees and expenses	(70)	(125)
Proceeds from exercise of stock options (including tax benefits) and employee stock purchases	-	9
Dividends paid	(440)	(439)
Net cash from financing activities	99,997	44,678

Cash and cash equivalents:		
Net change	2,492	1,811
Beginning balance	3,009	2,315
Ending balance	$5,501	$4,126

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

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Olympic Steel, Inc.

Supplemental Disclosures of Cash Flow Information

For the Six Months Ended June 30,

(in thousands)

	2018	**2017**
	(unaudited)	
Interest paid	$4,306	$2,955
Income taxes paid	$2,055	$4,944

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

Olympic Steel, Inc.

Notes to Unaudited Consolidated Financial Statements

June 30, 2018

1. ***<u>Basis of Presentation:</u>***

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 2018 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, 2017. All intercompany transactions and balances have been eliminated in consolidation.

The Company operates in three reportable segments; carbon flat products, specialty metals flat products, and tubular and pipe products. The carbon flat products segment and the specialty metals flat products segments are at times consolidated and referred to as the flat products segments. Certain of the flat products segments' assets and resources are shared by the carbon and specialty metals segments and both segments' products are stored in the shared facilities and, in some locations, processed on shared equipment. Due to the shared assets and resources, certain of the flat products segment expenses are allocated between the carbon flat products segment and the specialty metals flat products segment based upon an established allocation methodology. Through its carbon flat products segment, the Company sells and distributes large volumes of processed carbon and coated flat-rolled sheet, coil and plate products, and fabricated parts. Through its specialty metals flat products segment, the Company sells and distributes processed aluminum and stainless flat-rolled sheet and coil products, flat bar products and fabricated parts. Through its acquisition of Berlin Metals, LLC (Berlin Metals) on April 2, 2018, the specialty metals flat products segment expanded its product offerings to include differing types of stainless flat-rolled sheet and coil and prime tin mill products. Through its tubular and pipe products segment, which consists of the Chicago Tube and Iron subsidiary (CTI), the Company distributes metal tubing, pipe, bar, valves and fittings and fabricate pressure parts supplied to various industrial markets.

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

Impact of Recently Issued Accounting Pronouncements

In August 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No 2017-12, “Derivatives and Hedging”. This ASU aligns an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. To meet that objective, the ASU expands and refines hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. This ASU also makes certain targeted improvements to simplify the application of hedge accounting guidance and ease the administrative burden of hedge documentation requirements and assessing hedge effectiveness. This ASU is the final version of proposed ASU 2016-310, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities”, which has been deleted. For public business entities, this ASU is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early application is permitted in any interim period after issuance of the ASU. All transition requirements and elections should be applied to hedging relationships existing (that is, hedging relationships in which the hedging instrument has not expired, been sold, terminated, or exercised or the entity has not removed the designation of the hedging relationship) on the date of adoption. The effect of adoption should be reflected as of the beginning of the fiscal year of adoption. The adoption of this ASU is not expected to materially impact the Company’s consolidated financial statements.

In May 2017, the FASB issued ASU No 2017-09, “Compensation – Stock Compensation (Topic 718)”. This ASU provides clarity and reduces both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718, Compensation – Stock Compensation, to a change to the terms or conditions of a share-based payment award. The ASU provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. This ASU is the final version of proposed ASU 2016-360, “Compensation—Stock Compensation (Topic 718)—Scope of Modification Accounting,” which has been deleted. The amendments in this ASU are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The amendments in this ASU should be applied prospectively to an award modified on or after the adoption date. The adoption of this ASU did not materially impact the Company’s consolidated financial statements.

In August 2016, the FASB issued ASU No 2016-15, "Classification of certain cash receipts and cash payments". This ASU addresses the following eight specific cash flow issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The guidance will be effective for annual reporting periods beginning after December 15, 2017, and interim periods within those fiscal years with early adoption permitted. The adoption of this ASU did not materially impact the Company's consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases," which specifies the accounting for leases. The objective is to establish the principles that lessees and lessors shall apply to report useful information to users of financial statements about the amount, timing and uncertainty of cash flows arising from a lease. This ASU introduces the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous guidance. The guidance will be effective for annual reporting periods beginning after December 15, 2018 and interim periods within those fiscal years with early adoption permitted. The Company is in the process of evaluating the impact of the future adoption of this standard on the Company's consolidated financial statements.

In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date," which deferred the effective date of ASU 2014-09 for all entities by one year. This update is effective for public business entities for annual reporting periods beginning after December 15, 2017, including interim periods within those reporting periods. Earlier application was permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. ASU 2014-09 was to become effective for us beginning January 2017; however, ASU 2015-14 deferred our effective date until January 2018, which is when we adopted this standard. The ASU permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method). The ASU also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required for customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The Company completed the process of evaluating the effect of the adoption and determined there were no material changes required to the reported revenues as a result of the adoption. Substantially all of the revenue arrangements consist of a single performance obligation to transfer goods. Based on the evaluation process and review of the contracts with customers, the timing and amount of revenue recognized based on ASU 2015-14 is consistent with the revenue recognition policy under previous guidance. The adoption of this ASU on January 1, 2018 using the modified retrospective approach applied to those contracts which were not completed as of January 1, 2018 did not have a material impact on the Company's consolidated financial statements. Comparative information has not been restated and continues to be reported under the accounting standard in effect for those periods. The impact of adopting ASU 606 was not material to the Company's consolidated financial statements as of and for the three and six months ended June 30, 2018. See note 3.

2. <u>Acquisitions:</u>

On April 2, 2018, the Company acquired substantially all of the net assets of Berlin Metals, based in Hammond, Indiana, for $21.9 million. Berlin Metals was founded in 1967 and is one of the largest North American service centers processing and distributing prime tin mill products and stainless steel strip in slit coil form. Berlin Metals is also a supplier of galvanized, light gauge cold rolled sheet and strip and other coated metals in coil forms, to customers in the building products, automotive and specialized industrial markets.

The acquisition is not considered significant and thus pro-forma information has not been provided. The acquisition was accounted for as a business combination and the assets were valued at fair market value. The table below summarizes the purchase price allocation of the fair market values of the assets acquired and liabilities assumed.

Details of Acquisition (in thousands)	As of June 30, 2018
Assets acquired	
Accounts receivable	6,609
Inventories	14,769
Property and equipment	2,898
Prepaid expenses and other	345
Intangible assets	5,255
Total assets acquired	29,876
Total liabilities assumed	(7,969)
Cash paid	$21,907

As of the effective date of the acquisition, Berlin Metals' results are included in the Company's specialty metals flat products segment in the Company's second quarter of 2018 financial results. Upon the acquisition, the Company entered into an amendment to its asset-based credit facility to include the eligible assets of Berlin Metals.

3. <u>Revenue Recognition:</u>

The Company provides metals processing, distribution and delivery of large volumes of processed carbon, coated flat rolled sheet, coil and plate products, aluminum, and stainless flat rolled products, prime tin mill products, flat bar products, metal tubing, pipe, bar, valves, fittings, and fabricated parts. The Company's contracts with customers are comprised of purchase orders with standard terms and conditions. Occasionally the Company may also have longer-term agreements with customers. Substantially all of the contracts with customers require the delivery of metals which represent single performance obligations that are satisfied upon transfer of control of the product to the customer.

Transfer of control is assessed based on the use of the product distributed and rights to payment for performance under the contract terms. Transfer of control and revenue recognition for substantially all of the Company's sales occur upon shipment or delivery of the product, which is when title, ownership and risk of loss pass to the customer and is based on the applicable shipping terms. The shipping terms depend on the customer contract. An invoice for payment is issued at time of shipment and terms are generally net 30 days. The Company has certain fabrication contracts in one business unit for which revenue is recognized over time as performance obligations are achieved. This fabrication business is not material to the Company's consolidated results.

Within the metals industry, revenue is frequently disaggregated by products sold. The table below disaggregates the Company’s revenues by segment and products sold.

	Disaggregated Revenue by Products Sold For the Three Months Ended June 30, 2018			
	Carbon flat products	**Specialty metals flat products**	**Tubular and pipe products**	**Total**
Hot Rolled	35.0%			