OLYMPIC STEEL INC
Form 10-Q
August 09, 2012

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, 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 (State or other jurisdiction of incorporation or organization)	34-1245650 (I.R.S. Employer Identification No.)
5096 Richmond Road, Bedford Heights, Ohio (Address of principal executive offices)	44146 (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 a smaller reporting company. See the definitions of “large accelerated filer” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

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

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

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

Class	Outstanding as of August 9, 2012
Common stock, without par value	10,917,340

Olympic Steel, Inc.
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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	June 30, 2012 (unaudited)	December 31, 2011 (audited)
Assets		
Cash and cash equivalents	$2,816	$7,403
Accounts receivable, net	158,853	122,579
Inventories, net	312,275	277,765
Prepaid expenses and other	10,354	13,112
Total current assets	484,298	420,859
Property and equipment, at cost	343,279	329,116
Accumulated depreciation	(144,162)	(135,703)
Net property and equipment	199,117	193,413
Goodwill	47,370	47,254
Intangible assets, net	35,868	36,313
Other long-term assets	12,154	9,660
Total assets	$778,807	$707,499
Liabilities		
Current portion of long-term debt	$8,967	$9,662
Accounts payable	116,682	104,425
Accrued payroll	11,541	11,613
Other accrued liabilities	14,610	13,875
Total current liabilities	151,800	139,575
Credit facility revolver	219,915	170,405
Long-term debt	59,624	64,149
Other long-term liabilities	11,490	9,580
Deferred income taxes	37,806	37,214
Total liabilities	480,635	420,923
Shareholders' Equity		
Preferred stock	-	-
Common stock	121,496	119,816
Accumulated other comprehensive loss, net of tax	(403)	-
Retained earnings	177,079	166,760
Total shareholders' equity	298,172	286,576
Total liabilities and shareholders' equity	$778,807	$707,499

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

Olympic Steel, Inc.
Consolidated Statement of Comprehensive Income
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(unaudited)		(unaudited)	
Net sales	$367,365	$299,000	$749,417	$593,381
Costs and expenses				
Cost of materials sold (excludes items shown seperately below)	295,878	238,618	602,556	469,580
Warehouse and processing	21,003	16,371	42,225	31,961
Administrative and general	17,508	13,667	35,882	26,878
Distribution	9,219	6,139	18,278	12,347
Selling	6,763	5,127	13,904	10,931
Occupancy	2,115	1,667	4,438	3,493
Depreciation	4,913	3,512	9,683	6,979
Amortization	222	-	444	-
Total costs and expenses	357,621	285,101	727,410	562,169
Operating income	9,744	13,899	22,007	31,212
Other income, net	(5)	-	(39)	-
Income before interest and income taxes	9,749	13,899	22,046	31,212
Interest and other expense on debt	2,183	826	4,291	1,631
Income before income taxes	7,566	13,073	17,755	29,581
Income tax provision	3,040	5,127	6,999	11,312
Net income	$4,526	$7,946	$10,756	$18,269
Net loss on interest rate hedge, net of tax	(403)	-	(403)	-
Total comprehensive income	$4,123	$7,946	$10,353	$18,269
Earnings per share:				
Net income per share - basic	$0.41	$0.73	$0.98	$1.67
Weighted average shares outstanding - basic	10,960	10,935	10,956	10,935
Net income per share - diluted	$0.41	$0.73	$0.98	$1.67
Weighted average shares outstanding - diluted	10,989	10,947	10,987	10,947

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

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

	Six Months Ended June 30,	
	2012	2011
	(unaudited)	
Cash flows from (used for) operating activities:		
Net income	$10,756	$18,269
Adjustments to reconcile net income to net cash used for operating activities -		
Depreciation and amortization	10,753	7,132
Loss on disposition of property and equipment	174	39
Stock-based compensation	1,436	404
Other long-term assets	(2,032)	(209)
Other long-term liabilities	1,255	3,512
	22,342	29,147
Changes in working capital:		
Accounts receivable	(36,274)	(57,629)
Inventories	(34,510)	(6,972)
Income taxes receivable and deferred	844	3,911
Prepaid expenses and other	2,758	(967)
Accounts payable	8,628	15,530
Change in outstanding checks	3,629	4,277
Accrued payroll and other accrued liabilities	782	(4,777)
	(54,143)	(46,627)
Net cash used for operating activities	(31,801)	(17,480)
Cash flows from (used for) investing activities:		
Capital expenditures	(15,683)	(16,416)
Proceeds from disposition of property and equipment	2	12
Net cash used for investing activities	(15,681)	(16,404)
Cash flows from (used for) financing activities:		
Credit facility revolver borrowings	303,470	231,475
Credit facility revolver repayments	(253,960)	(195,520)
Principal payments under capital lease obligations	(90)	-
Term loan repayments	(4,375)	-
Industrial revenue bond repayments	(755)	-
Credit facility fees and expenses	(1,203)	(760)
Proceeds from exercise of stock options (including tax benefits) and employee stock purchases	244	20
Dividends paid	(436)	(436)
Net cash from financing activities	42,895	34,779
Cash and cash equivalents:		
Net change	(4,587)	895
Beginning balance	7,403	1,492
Ending balance	$2,816	$2,387

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

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

	Six Months Ended June 30,	
	2012	2011
	(unaudited)	
Cash paid during the period		
Interest paid	$3,816	$1,473
Income taxes paid	$3,344	$6,688

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

Olympic Steel, Inc.

Notes to Consolidated Financial Statements

(unaudited)

June 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. CTI stocks, processes and fabricates metal tubing, pipe, bar, valves and fittings and pressure parts at nine operating facilities located primarily throughout the Midwestern United States. The Company paid for goodwill in conjunction with the acquisition, as CTI enhances the Company's commercial opportunities by adding new product offerings to an expanded customer base and by increasing the Company's distribution footprint.

The Company paid total cash consideration of $159.9 million, consisting of a base purchase price of $150.0 million, plus the closing cash, working capital and McNeeley purchase agreement payments (as disclosed in the Current Report on Form 8-K filed on May 20, 2011) totaling approximately $9.9 million. In addition, the Company assumed approximately $5.9 million of indebtedness and acquired $11.1 million of cash from CTI. Olympic funded its acquisition of CTI primarily with borrowings under its amended asset-based credit facility. During the second and third quarters of 2011, the Company incurred $919 thousand of direct acquisition-related costs in the aggregate.

Purchase Price Allocation

The acquisition of CTI was accounted for under the acquisition method of accounting and, accordingly, the purchase price of $159.9 million has been allocated to the assets acquired and liabilities assumed at July 1, 2011, the date of acquisition. There were no material changes to the purchase price allocation since December 31, 2011.

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 three and six months ended June 30, 2011 does not include any transactions 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.

(in thousands, except per share amounts)	Three months ended June 30, 2011	Six months ended June 30, 2011
Pro forma (unaudited):		
Net sales	$ 358,789	$ 713,888
Net income	$ 9,602	$ 20,917
Basic earnings per common share	$ 0.88	$ 1.91
Diluted earnings per common share	$ 0.88	$ 1.91

(3) Accounts Receivable:

The Company maintained allowances for doubtful accounts and unissued credits of $3.5 million and $2.9 million at June 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 June 30, 2012, approximately $46.1 million, or 14.8% 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 second 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 June 30, 2012.

Metal inventories consist of the following:

(in thousands)	June 30, 2012	December 31, 2011
Unprocessed	$ 229,275	$ 207,301
Processed and finished	83,000	70,464
Totals	$ 312,275	$ 277,765

(5) Intangible Assets:

Intangible assets, net, consisted of the following as of June 30, 2012:

(in thousands)	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, Net
Customer relationships - subject to amortization	$13,332	$(889)	$12,443
Trade name - not subject to amortization	23,425	-	23,425
	$36,757	$(889)	$35,868

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:

(in thousands)	June 30, 2012	December 31, 2011
Flat products	$ 7,083	$ 7,083
Tubular and pipe products	40,287	40,171
Total	$ 47,370	$ 47,254

The goodwill of $47.4 million 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 substantially in excess of the carrying values of the entities and there were no indications of impairment.

(7) Investments in Joint Ventures:

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

In May 2012 the real estate associated with OLP was sold. The sale of the OLP real estate was completed on May 18, 2012, resulting in a pre-tax loss on sale to the Company of $9 thousand. The Company is in the process of finalizing all of the transactions related to the sale of the real estate and dissolving OLP.

(8) Debt:

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

(in thousands)	June 30, 2012	December 31, 2011
Asset-based revolving credit facility due June 30, 2016	$219,915	$170,405
Term loan due June 30, 2016	61,979	66,354
Industrial revenue bond due April 1, 2018	5,125	5,880
Capital lease	1,487	1,577
Total debt	288,506	244,216
Less current amount	(8,967)	(9,662)
Total long-term debt	$279,539	$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. 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 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, or 60% of the principal balance of the term loan then outstanding, 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%.

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%. Although the Company is exposed to credit loss in the event of nonperformance by the other parties to the interest rate hedge agreement, the Company anticipates performance by the counterparties.

As of June 30, 2012, $5.4 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 of June 30, 2012, the Company was in compliance with its covenants and had approximately $85 million of availability under 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). The bond matures in April 2018, with the option to provide principal payments annually on April 1st. On April 1, 2012, the Company paid an optional principal payment of $755 thousand. 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 June 30, 2012 was 0.23% 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 June 30, 2012, the effect of the swap agreement on the bond was to fix the rate at 3.46 percent. 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 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.

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 Sheet at June 30, 2012 and December 31, 2011.

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 six months ended June 30, 2012 and 2011.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
(in thousands)				
Interest rate swap	$(5)	$-	$16	$-
Nickel swaps	(164)	(16)	(229)	72
Embedded customer derivatives	164	16	229	(72)
Total (income) expense	$(5)	$-	$16	$-

(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 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 six months ended June 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 June 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) June 30, 2012	Level 1	Level 2	Level 3	Total
Assets:				
Embedded customer derivatives	$-	$229	$-	$229
Liabilities:				
Nickel swaps	-	284	-	284
Interest rate swap		476		476
Fixed interest rate hedge	-	655	-	655
Total liabilities at fair value	$-	$1,415	$-	$1,415

(in thousands) December 31, 2011	Level 1	Level 2	Level 3	Total
Assets:				
Embedded customer derivatives	$-	$55	$-	$55
Liabilities:				
Nickel swaps	-	55	-	55
Interest rate swap	-	492	-	492
Total liabilities at fair value	$-	$547	$-	$547

Long-Term Financial Instruments

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 both $4.3 million and $5.1 million at June 30, 2012 and December 31, 2011, respectively.

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 $219.9 million and $54.0 million, at June 30, 2012, respectively. The carrying value of the revolver and the term loan were $170.4 million and $57.6 million, at December 31, 2011, respectively. As the revolver and term loan were amended in 2012, refinanced in 2011, and carry variable interest rates, management believes that the amounts are carried at fair value at June 30, 2012 and December 31, 2011.

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(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 $655 thousand, net of tax of $252 thousand is included in "Accumulated other comprehensive loss" on the Consolidated Balance Sheets at June 30, 2012.

(12) Equity Plans:

Stock Options

The following table summarizes stock option activity during the six months ended June 30, 2012:

	Number of Options	Weighted Average Exercise Price		Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)	
Outstanding at December 31, 2011	46,007	$	20.90			
Granted	-		-			
Exercised	(2,170)		4.18			
Canceled	-		-			
Outstanding at June 30, 2012	43,837	$	21.73	3.3 years	$	143
Exercisable at June 30, 2012	43,837	$	21.73	3.3 years	$	143

There were 2,170 stock options exercised during the six months ended June 30, 2012. There were no stock options exercised during the six months ended June 30, 2011. The total intrinsic value of stock options exercised during the six months ended June 30, 2012 was $52 thousand. All options outstanding are vested as of June 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 the executives. 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 to the stock ownership requirements will be ineligible to receive any equity awards under the Company's equity compensation plans, including the Plan, until the participant satisfies the ownership requirements. To assist participants in meeting the stock ownership requirements, on an annual basis, if a participant purchases 500 shares of Common Stock on the open market, the Company will award that participant 250 shares of Common Stock. During the six months ended June 30, 2102 the Company matched 6,750 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 six months ended June 30, 2012 and 2011, respectively, is summarized in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
(in thousands, except per share data)				
RSU expense before taxes	$ 272	$ 129	$ 552	$ 216
RSU expense after taxes	$ 163	$ 78	$ 335	$ 133
Impact per basic share	$ 0.01	$ 0.01	$ 0.03	$ 0.01
Impact per diluted share	$ 0.01	$ 0.01	$ 0.03	$ 0.01

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 six months ended June 30, 2012:

	Number of Shares	Weighted Average Granted Price	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2011	147,603	$ 27.16	
Granted	40,368	23.97	
Converted into shares	(375)	22.68	
Forfeited	-	-	
Outstanding at June 30, 2012	187,596	$ 26.48	-
Vested at June 30, 2012	121,443	$ 25.95	-

During the six months ended June 30, 2012, 375 RSUs were converted into shares. No RSUs were converted into shares during the six months ended June 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” and “Long-term debt” on the accompanying Consolidated Balance Sheet.

The capital lease obligation is as follows:

(in thousands)	June 30, 2012	December 31, 2011
Total capital lease obligation	$ 1,491	$ 1,587
Less: interest	(4)	(10)
Capital lease obligation	1,487	