OLYMPIC STEEL INC
Form 10-Q
November 03, 2016

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, 2016

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

For the transition period from __________ to ____________

Commission File Number 0-23320

OLYMPIC STEEL, INC.

(Exact name of registrant as specified in its charter)

Ohio (State or other jurisdiction of incorporation or organization)	34-1245650 (I.R.S.Employer Identification Number)
22901 Millcreek Boulevard, Suite 650, Highland Hills, OH (Address of principal executive offices)	44122 (Zip Code)

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 November 3, 2016
Common stock, without par value	10,963,448

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 September 30, 2016 (unaudited)	December 31, 2015
Assets		
Cash and cash equivalents	$2,845	$1,604
Accounts receivable, net	110,989	92,877
Inventories, net (includes LIFO debit of $7,255 and $6,555 as of September 30, 2016 and December 31, 2015, respectively)	230,820	206,645
Prepaid expenses and other	6,225	7,820
Total current assets	350,879	308,946
Property and equipment, at cost	373,585	372,129
Accumulated depreciation	(214,943)	(205,591)
Net property and equipment	158,642	166,538
Intangible assets, net	24,091	24,757
Other long-term assets	16,355	13,229
Total assets	$549,967	$513,470
Liabilities		
Current portion of long-term debt	$1,825	$2,690
Accounts payable	65,079	55,685
Accrued payroll	9,285	6,884
Other accrued liabilities	14,658	11,801
Total current liabilities	90,847	77,060
Credit facility revolver	163,516	145,800
Other long-term liabilities	14,668	11,419
Deferred income taxes	25,369	24,496
Total liabilities	294,400	258,775
Shareholders' Equity		
Preferred stock	-	-
Common stock	128,563	128,129
Treasury stock	(699)	(699)

Accumulated other comprehensive loss	-	(70)
Retained earnings	127,703	127,335
Total shareholders' equity	255,567	254,695
Total liabilities and shareholders' equity	$549,967	$513,470

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		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(unaudited)			
Net sales	$268,255	$276,922	$800,212	$938,038
Costs and expenses				
Cost of materials sold (excludes items shown separately below)	211,037	218,172	616,545	753,949
Warehouse and processing	20,034	21,261	61,561	65,520
Administrative and general	16,003	15,943	48,054	49,287
Distribution	8,995	8,950	27,762	27,819
Selling	5,629	5,315	17,361	16,106
Occupancy	2,135	2,196	6,630	7,212
Depreciation	4,172	4,409	13,231	13,627
Amortization	223	223	667	667
Goodwill and intangible asset impairment	-	-	-	24,451
Total costs and expenses	268,228	276,469	791,811	958,638
Operating income (loss)	27	453	8,401	(20,600)
Other income (loss), net	21	(84)	(42)	(141)
Income (loss) before interest and income taxes	48	369	8,359	(20,741)
Interest and other expense on debt	1,336	1,405	3,895	4,439
Income (loss) before income taxes	(1,288)	(1,036)	4,464	(25,180)
Income tax provision (benefit)	469	(438)	3,438	(3,391)
Net income (loss)	$(1,757)	$(598)	$1,026	$(21,789)
Gain/(loss) on cash flow hedge	-	(278)	-	(1,817)
Tax effect on cash flow hedge	-	107	-	699
Reclassification of loss included in net income, net of tax of $180 and $533 for the three and nine months ended September 30, 2015, respectively.	-	364	-	1,097
Total comprehensive income (loss)	$(1,757)	$(405)	$1,026	$(21,810)
Earnings per share:				
Net income (loss) per share - basic	$(0.16)	$(0.05)	$0.09	$(1.95)
Weighted average shares outstanding - basic	11,219	11,203	11,206	11,200
Net income (loss) per share - diluted	$(0.16)	$(0.05)	$0.09	$(1.95)
Weighted average shares outstanding - diluted	11,219	11,203	11,206	11,200

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

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Olympic Steel, Inc.

Consolidated Statements of Cash Flows

For the Nine Months Ended September 30,

(in thousands)

	2016 (unaudited)	**2015**
Cash flows from (used for) operating activities:		
Net income (loss)	$ 1,026	$ (21,789)
Adjustments to reconcile net income (loss) to net cash from (used for) operating activities -		
Depreciation and amortization	14,586	14,902
Goodwill and intangible asset impairment	-	24,451
Gain on disposition of property and equipment	(161)	-
Stock-based compensation	400	1,680
Other long-term assets	(3,713)	704
Other long-term liabilities	4,192	(9,526)
	16,330	10,422
Changes in working capital:		
Accounts receivable	(18,112)	8,649
Inventories	(24,175)	82,077
Prepaid expenses and other	1,618	13,908
Accounts payable	10,913	(19,373)
Change in outstanding checks	(1,518)	(14,484)
Accrued payroll and other accrued liabilities	5,256	(11,862)
	(26,018)	58,915
Net cash from (used for) operating activities	(9,688)	69,337
Cash flows from (used for) investing activities:		
Capital expenditures	(5,335)	(6,017)
Proceeds from disposition of property and equipment	161	3
Net cash used for investing activities	(5,174)	(6,014)
Cash flows from (used for) financing activities:		
Credit facility revolver borrowings	230,911	283,092
Credit facility revolver repayments	(213,195)	(342,002)
Industrial revenue bond repayments	(865)	(840)
Credit facility fees and expenses	(125)	(125)
Proceeds from exercise of stock options (including tax benefits) and employee stock purchases	34	14
Dividends paid	(657)	(660)
Net cash from (used for) financing activities	16,103	(60,521)

Cash and cash equivalents:		
Net change	1,241	2,802
Beginning balance	1,604	2,238
Ending balance	$2,845	$5,040

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 Nine Months Ended September 30,

(in thousands)

	2016	**2015**
	(unaudited)	
Interest paid	$3,257	$3,898
Income taxes paid	$890	$693

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

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Olympic Steel, Inc.

Notes to Unaudited Consolidated Financial Statements

September 30, 2016

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 2016 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, 2015. 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. 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. 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 tubular and pipe products segment, the Company distributes metal tubing, pipe, bar, valve and fittings and fabricates pressure parts supplied to various industrial markets.

Corporate expenses are reported as a separate line item 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.

***2. Accounts Receivable*:**

Accounts receivable are presented net of allowances for doubtful accounts and unissued credits of $2.6 million and $3.1 million as of September 30, 2016 and December 31, 2015, respectively. The allowance for doubtful accounts is maintained at a level considered appropriate based on historical experience and specific customer collection issues that have been identified. Estimations are based upon a calculated percentage of accounts receivable, which remains fairly level from year to year, and judgments about the probable effects of economic conditions on certain customers, which can fluctuate significantly from year to year. The Company cannot guarantee that the rate of future credit losses will be similar to past experience. The Company considers all available information when assessing the adequacy of its allowance for doubtful accounts and unissued credits each quarter.

3. Inventories:

Inventories consisted of the following:

(in thousands)	**Inventory as of September 30, 2016**	**December 31, 2015**
Unprocessed	$ 185,553	$ 163,942
Processed and finished	45,267	42,703
Totals	$ 230,820	$ 206,645

The Company values certain of its tubular and pipe products inventory under the last-in, first-out (LIFO) method. At September 30, 2016 and December 31, 2015, approximately $42.7 million, or 18.5% of consolidated inventory, and $42.7 million, or 20.7% of consolidated inventory, respectively, was reported under the LIFO method of accounting. The cost of the remainder of the tubular and pipe products inventory is determined using a weighted average rolling first-in, first-out (FIFO) method.

For the three and nine months ended September 30, 2016, the Company recorded $0.7 million of LIFO income as a result of expected year-over-year decreases in carbon steel pricing and expected higher levels of inventory. For the nine months ended September 30, 2015, the Company recorded $1.7 million of LIFO income as a result of then expected year-over-year decreases in carbon, nickel and base stainless steel pricing offset by expected lower inventory quantities at December 31, 2015. Of the $1.7 million LIFO income, $1.1 million was recorded in the third quarter of 2015. The LIFO income increased the Company’s inventory balance and decreased its cost of materials sold.

If the FIFO method had been in use, inventories would have been $7.3 million and $6.6 million lower than reported at September 30, 2016 and December 31, 2015, respectively.

4. ***Debt*:**

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

(in thousands)	As of September 30, 2016	December 31, 2015
Asset-based revolving credit facility due June 30, 2019	$ 163,516	$ 145,800
Industrial revenue bond due April 1, 2018	1,825	2,690
Total debt	165,341	148,490
Less current amount	(1,825)	(2,690)
Total long-term debt	$ 163,516	$ 145,800

The Company's existing asset-based credit facility (the ABL Credit Facility) is collateralized by the Company's accounts receivable and inventory. The ABL Credit Facility consists of a revolving credit line of $365 million. Revolver borrowings are limited to the lesser of a borrowing base, comprised of eligible receivables and inventories, or $365 million in the aggregate. The ABL Credit Facility matures on June 30, 2019.

The ABL Credit Facility requires the Company to comply with various covenants, the most significant of which include: (i) until maturity of the ABL Credit Facility, if any commitments or obligations are outstanding and the Company's availability is less than the greater of $30 million or 10.0% of the aggregate amount of revolver commitments ($36.5 million at September 30, 2016), then the Company must maintain a ratio of EBITDA minus certain capital expenditures and cash taxes paid to fixed charges of at least 1.00 to 1.00 for the most recent twelve fiscal month period; (ii) limitations on dividend payments and common stock repurchases; and (iii) restrictions on additional indebtedness. The Company has the option to borrow under its revolver based on the agent's base rate plus a premium ranging from 0.00% to 0.25% or the London Interbank Offered Rate (LIBOR) plus a premium ranging from 1.25% to 3.00%.

As of September 30, 2016, the Company was in compliance with its covenants and had approximately $86.1 million of availability under the ABL Credit Facility.

As of September 30, 2016, $2.2 million of bank financing fees were included in “Prepaid expenses and other” and “Other long-term assets” on the accompanying Consolidated Balance Sheets. The financing fees are being amortized over the five-year term of the ABL Credit facility and are included in “Interest and other expense on debt” on the accompanying Consolidated Statements of Comprehensive Income.

As part of the Chicago Tube and Iron (CTI) acquisition in July 2011, the Company assumed approximately $5.9 million of Industrial Revenue Bond (IRB) indebtedness issued through the Stanly County, North Carolina Industrial Revenue and Pollution Control Authority. The bond matures in April 2018, with the option to provide principal payments annually on April 1st. On April 1, 2016, the Company paid an optional principal payment of $865 thousand. Since the IRB is remarketed annually, it is included in “Current portion of long-term debt” on the accompanying Consolidated Balance Sheets. Interest is payable monthly, with a variable rate that resets weekly. As a security for payment of the bonds, the Company obtained a direct pay letter of credit issued by JPMorgan Chase Bank, N.A. The letter of credit reduces annually by the principal reduction amount. The interest rate at September 30, 2016 was 1.1% for the IRB debt.

CTI entered into an interest rate swap agreement to reduce the impact of changes in interest rates on the above IRB. At September 30, 2016, the effect of the swap agreement on the bond was to fix the rate at 3.46%. The swap agreement matures in April 2018, and is reduced annually by the amount of the optional principal payments on the bond. The Company is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreement. However, the Company does not anticipate nonperformance by the counterparties.

5. <u>Derivative Instruments</u>:

Metals swaps and embedded customer derivatives

During 2016 and 2015, the Company entered into nickel swaps indexed to the London Metal Exchange (LME) price of nickel with third-party brokers. The nickel swaps are accounted for as derivatives for accounting purposes. The Company entered into them to mitigate its customers' risk of volatility in the price of metals. The outstanding nickel swaps have one to two months remaining. The swaps are settled with the brokers at maturity. The economic benefit or loss arising from the changes in fair value of the swaps is contractually passed through to the customer. The primary risk associated with the metals swaps is the ability of customers or third-party brokers to honor their agreements with the Company related to derivative instruments. If the customer or third-party brokers are unable to honor their agreements, the Company's risk of loss is the fair value of the metals swaps.

While these derivatives are intended to help the Company manage risk, they have not been designated as hedging instruments. The periodic changes in fair value of the metals and embedded customer derivative instruments are included in "Cost of materials sold" in the Consolidated Statements of Comprehensive Income. The Company recognizes derivative positions with both the customer and the third party for the derivatives and classifies cash settlement amounts associated with them as part of "Cost of materials sold" in the Consolidated Statements of Comprehensive Income. The cumulative change in fair value of the metals swaps that have not yet been settled are included in "Accounts receivable, net", and the embedded customer derivatives are included in "Other accrued liabilities" on the Consolidated Balance Sheets at September 30, 2016. At December 31, 2015, the cumulative change in fair value of the metals swaps that had not yet settled were included in "Other accrued liabilities", and the embedded customer derivatives were included in "Accounts receivable, net" on the Consolidated Balance Sheets.

In 2014, the Company entered into carbon swaps to mitigate its risk of volatility in the price of metals. The swaps were indexed to the New York Mercantile Exchange price of U.S. Midwest Domestic Hot-Rolled Coil Steel with third-party brokers and the carbon swaps matured during 2015. The periodic change in fair value of the metals hedges were included in "Accumulated other comprehensive loss" on the Consolidated Balance Sheet at December 31, 2015. The impact of the mark-to-market adjustment on settled hedges is recorded in "Cost of materials sold" in the accompanying Consolidated Statements of Comprehensive Income. The impact for the three and nine months ended September 30, 2015 was $544 thousand and $1.6 million of expense, respectively.

Interest rate swap

CTI entered into an interest rate swap to reduce the impact of changes in interest rates on its IRB. The swap agreement matures in April 2018, the same time as the IRB, and is reduced annually by the amount of the optional principal payments on the IRB. The Company is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreement. However, the Company does not anticipate nonperformance by the counterparties. The interest rate swap is not treated as a hedge for accounting purposes.

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

Fixed rate interest rate hedge

In June 2012, the Company entered into a forward starting fixed rate interest rate hedge commencing June 2013 in order to eliminate the variability of cash interest payments on $53.2 million of the then outstanding LIBOR-based borrowings under the ABL Credit Facility. The hedge, which matured on June 1, 2016, fixed the rate at 1.21% plus a premium ranging from 1.25% to 1.75%. The fixed rate interest rate hedge was accounted for as a cash flow hedging instrument for accounting purposes.

There was no net impact from the nickel swaps or embedded customer derivative agreements to the Company's Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2016 and 2015. The table below shows the total impact to the Company's Consolidated Statements of Comprehensive Income through net income of the derivatives for the three and nine months ended September 30, 2016 and 2015.

	Net Gain (Loss) Recognized			
	For the Three Months Ended September 30,		**For the Nine Months Ended September 30,**	
(in thousands)	**2016**	**2015**	**2016**	**2015**
Interest rate swap (CTI)	$(19)	$(15)	$(52)	$(50)
Fixed interest rate swap (ABL)	-	(90)	(98)	(284)
Cash flow metals hedges	-	(544)	-	(1,629)
Metals swaps	111	(571)	173	(1,958)
Embedded customer derivatives	(111)	571	(173)	1,958
Total loss	$(19)	$(649)	$(150)	$(1,963)

6. ***Fair Value of Financial Instruments:***

During the three months ended September 30, 2016, there were no transfers of financial assets between Levels 1, 2 or 3 fair value measurements. There have been no changes in the methodologies used at September 30, 2016 since December 31, 2015. Following is a description of the valuation methodologies used for assets and liabilities measured at fair value as of September 30, 2016 and December 31, 2015:

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

The following table presents information about the Company's assets and liabilities that were measured at fair value on a recurring basis and indicates the fair value hierarchy of the valuation techniques utilized by the Company:

(in thousands)	Value of Items Recorded at Fair Value As of September 30, 2016 Level 1	Level 2	Level 3	Total
Assets:				
Metals swaps	$-	$87	$ -	$87
Total assets at fair value	**$-**	**$87**	**$ -**	**$87**
Liabilities:				
Embedded customer derivative	$-	$87	$ -	$87
Interest rate swap (CTI)	-	49	-	49
Total liabilities recorded at fair value	**$-**	**$136**	**$ -**	**$136**

(in thousands)	Value of Items Not Recorded at Fair Value As of September 30, 2016 Level 1	Level 2	Level 3	Total
Liabilities:				
IRB	$1,825	$-	$ -	$1,825
Revolver	-	163,516	-	163,516
Total liabilities not recorded at fair value	**$1,825**	**$163,516**	**$ -**	**$165,341**

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 As of December 31, 2015 Level 1	Level 2	Level 3	Total
Assets:				
Embedded customer derivative	$-	$384	$ -	$384
Total assets at fair value	**$-**	**$384**	**$ -**	**$384**
Liabilities:				
Metals swaps	$-	$384	$ -	$384
Interest rate swap (CTI)	-	102	-	102
Fixed interest rate swap (ABL)	-	114	-	114
Total liabilities recorded at fair value	**$-**	**$600**	**$ -**	**$600**

(in thousands)	Value of Items Not Recorded at Fair Value As of December 31, 2015 Level 1	Level 2	Level 3	Total
Liabilities:				
IRB	$2,690	$-	$ -	$2,690
Revolver	-	145,800	-	145,800
Total liabilities not recorded at fair value	**$2,690**	**$145,800**	**$ -**	**$148,490**

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 $1.8 million and $2.7 million at September 30, 2016 and December 31, 2015, respectively.

The fair value of the revolver is determined using Level 2 inputs. The Level 2 fair value of the Company's long-term debt was estimated using prevailing market interest rates on debt with similar credit worthiness, terms and maturities.

7. ***Equity Plans:***

Pursuant to the Amended and Restated Olympic Steel 2007 Omnibus Incentive Plan (Plan), the Company may grant stock options, stock appreciation rights, restricted shares, restricted share units, performance shares, and other stock-and cash-based awards to employees and Directors of, and consultants to, the Company and its affiliates. Under the Plan, 1,000,000 shares of common stock are available for equity grants.

On May 1, 2016 and March 1, 2015, the Compensation Committee of the Company's Board of Directors approved the grant of 3,094 and 4,639 restricted stock units (RSUs), respectively, 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 $22.62 and $15.09 on May 1, 2016 and March 1, 2015, respectively.

The Company's Senior Management Compensation Program includes an equity component in order to encourage more ownership of common stock by the senior management. The Senior Management Compensation Program imposes stock ownership requirements upon the participants. Each participant is required to own at least 750 shares of common stock for each year that the participant participates in the Senior Management Compensation Program. Any participant that fails to meet 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, 2016 and 2015, the Company matched 2,500 and 8,750 shares, respectively. Additionally, any participant who continues to comply with the stock ownership requirements as of the five-year, 10-year, 15-year, 20-year and 25-year anniversaries of the participant's participation in the Senior Management Compensation Program will receive a restricted stock unit award with a dollar value of $25 thousand, $50 thousand, $75 thousand, $100 thousand and $100 thousand, respectively. Restricted stock unit awards will convert into the right to receive shares of common stock upon a participant's retirement, or earlier upon the participant's death or disability or upon a change in control of the Company.

The above liability award plan was terminated for the carbon and specialty metals flat products segments on June 30, 2016 and will be terminated for the tubular and pipe products segment on December 31, 2016. The old plan has been replaced with a new equity award plan discussed below. As part of the termination of the old plan and the transition to the new plan, participants were paid the RSU grants that were earned to date, or a pro-rata amount of the RSUs earned, depending on the participants' length of time they participated in the plan. After the payment of the RSUs noted above, the remaining liability of approximately $880 thousand was reversed in the second quarter of 2016 in accordance with Accounting Standards Codification No. 718.

On July 1, 2016, the Company created a new Senior Management Stock Incentive Program for certain participants. Under the new program, each participant is awarded RSUs with a dollar value equal to 10% of the participant's base salary, up to a maximum of $17,500. The RSUs have a five-year vesting period and the RSUs will convert into the right to receive shares of common stock upon a participant's retirement, or earlier upon the participant's death or disability or upon a change in control of the Company. The carbon and specialty metals flat products segments adopted this new plan on July 1, 2016 and the tubular and pipe products segment will adopt the new plan on January 1, 2017.

During the third quarter of 2016, the Company adopted a formal RSU award program for employees who are promoted to an executive level position. During the quarter, Andrew Greiff received 10,573 RSUs upon his promotion to Executive Vice President and Chief Operating Officer.

Stock-based compensation expense or income recognized on RSUs for the three and nine months ended September 30, 2016 and 2015, respectively, is summarized in the following table:

	For the Three Months Ended September 30,		**For the Nine Months Ended September 30,**	
(in thousands, except per share data)	**2016**	**2015**	**2016**	**2015**
RSU expense (income) before taxes	$162	$326	$(170)	$867
RSU expense (income) after taxes	$220	$188	$(39)	$530

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

The following table summarizes the activity related to RSUs for the nine months ended September 30, 2016:

	Number of Shares	**Weighted Average Granted Price**	**Aggregate Intrinsic Value (in thousands)**
Outstanding at December 31, 2015	287,894	$ 22.39	
Granted	137,935	15.19	
Converted into shares	(3,239)	19.12	
Forfeited	(1,104)	18.03	
Outstanding at September 30, 2016	421,486	$ 19.92	$ 1,587
Vested at September 30, 2016	407,192	$ 19.86	$ 1,579

During the nine months ended September 30, 2016 and 2015, 3,239 and 2,437 RSUs, respectively, were converted into shares.

8. ***<u>Commitments and Contingencies</u>:***

The Company is party to various legal actions that it believes are ordinary in nature and incidental to the operation of its business. In the opinion of management, the outcome of the proceedings to which the Company is currently a party will not have a material adverse effect upon its results of operations, financial condition or cash flows. During the three and nine months ended September 30, 2016, the Company accrued an amount of $1.7 million related to an arbitration decision for a 2015 foreign steel purchase which was paid in October 2016. The amount was included in “Cost of materials sold” in the Consolidated Statements of Comprehensive Income. We have not incurred any charges of this nature in the comparable periods.

9. <u>Income Taxes</u>:

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

An income tax provision of $0.5 million on loss before taxes of $1.3 million was recorded for the three months ended September 30, 2016 resulting in an effective tax rate of negative 36.4%, compared to an income tax benefit of $0.4 million on loss before taxes of $1.0 million, or 42.3% for the three months ended September 30, 2015. The tax provision recorded for the three months ended September 30, 2016 is primarily a result of an increase in tax expense from state and local income taxes applied against forecasted income for 2016 and discrete tax expense recorded during the third quarter of 2016, applied against a net loss for the quarter.

For the nine months ended September 30, 2016, the Company recorded an income tax provision of $3.4 million, or 77.0% of income before taxes, compared to an income tax benefit of $3.4 million, or 13.5%, for the nine months ended September 30, 2015. Through the nine months ended September 30, 2016, the Company recorded a valuation allowance of $0.8 million to reduce certain state deferred tax assets to the amount that is more likely than not to be realized. The valuation allowance increased the Company’s effective tax rate by 18.3% for the nine months ended September 30, 2016. During the nine months ended September 30, 2015, the Company recorded a $16.5 million goodwill impairment charge pertaining to its tubular and pipe products segment. This non-deductible impairment charge reduced the Company’s effective tax rate by 25.3% for the nine months ended September 30, 2015.

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

10. <u>Shares Outstanding and Earnings Per Share</u>:

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

(in thousands, except per share data)	For the Three Months Ended September 30, 2016	2015	For the Nine Months Ended September 30, 2016	2015
Weighted average basic shares outstanding	11,219	11,203	11,206	11,200
Assumed exercise of stock options and issuance of stock awards	-	-	-	-
Weighted average diluted shares outstanding	11,219	11,203	11,206	11,200
Net income (loss)	$(1,757)	$(598)	$1,026	$(21,789)
Basic earnings (loss) per share	$(0.16)	$(0.05)	$0.09	$(1.95)
Diluted earnings (loss) per share	$(0.16)	$(0.05)	$0.09	$(1.95)
Anti-dilutive securities outstanding	167	124	167	124

11. <u>Segment Information</u>:

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

The Company operates in three reportable segments; carbon flat products, specialty metals flat products, and tubular and pipe products. 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 processed on the shared equipment. As such, total assets and capital expenditures are reported in the aggregate for the flat products segments. 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. 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 tubular and pipe products segment, the Company distributes metal tubing, pipe, bar, valve and fittings and fabricates pressure parts supplied to various industrial markets.

Corporate expenses are reported as a separate line item 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.

The following table provides financial information by segment and reconciles the Company’s operating income by segment to the consolidated income before income taxes for the three and nine months ended September 30, 2016 and 2015.

(in thousands)	**For the Three Months Ended September 30, 2016**	**2015**	**For the Nine Months Ended September 30, 2016**	**2015**
Net sales				
Carbon flat products	$169,372	$176,656	$503,928	$614,408
Specialty metals flat products	49,539	46,470	144,898	151,816
Tubular and pipe products	49,344	53,796	151,386	171,814
Total net sales	$268,255	$276,922	$800,212	$938,038
Depreciation and amortization				
Carbon flat products	$2,795	$2,905	$8,737	$9,213
Specialty metals flat products	203	175	586	525
Tubular and pipe products	1,372	1,527	4,499	4,480
Corporate	25	25	76	76
Total depreciation and amortization	$4,395	$4,632	$13,898	$14,294
Operating income (loss)				
Carbon flat products	$(3,613)	$(1,100)	$(122)	$(929)
Specialty metals flat products	3,003	(358)	7,326	(340)
Tubular and pipe products	2,773	3,685	7,149	10,443
Corporate	(2,136)	(1,774)	(5,952)	(5,323)
Goodwill and intangible asset impairment (a)	-	-	-	(24,451)
Total operating income (loss)	$27	$453	$8,401	$(20,600)
Other income (loss), net	21	(84)	(42)	(141)
Income (loss) before interest and income taxes	48	369	8,359	(20,741)
Interest and other expense on debt	1,336	1,405	3,895	4,439
Income (loss) before income taxes	$(1,288)	$(1,036)	$4,464	$(25,180)

(a) The goodwill and intangible asset impairments relate to the Company's tubular and pipe products segment.

For the Three Months Ended	**For the Nine Months Ended**

(in thousands)	September 30, 2016	2015	September 30, 2016	2015
Capital expenditures				
Flat products	$1,145	$1,148	$3,930	$3,254
Tubular and pipe products	593	636	1,405	2,763
Corporate	-	-	-	-
Total capital expenditures				