

UNIVERSAL STAINLESS & ALLOY PRODUCTS INC
Form 10-Q
May 09, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 March 31, 2008

OR

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

For the Transition Period from _____ to

Commission File Number 000-25032

UNIVERSAL STAINLESS & ALLOY PRODUCTS, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

25-1724540
(IRS Employer
Identification No.)

600 Mayer Street

Bridgeville, PA 15017

(Address of principal executive offices, including zip code)

(412) 257-7600

(Registrant's telephone number, including area code)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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 NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer 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 in Rule 12b-2 of the Exchange Act). YES NO

As of April 30, 2008, there were 6,698,499 shares of the Registrant's Common Stock issued and outstanding.

UNIVERSAL STAINLESS & ALLOY PRODUCTS, INC.

Management's Discussion and Analysis and other sections of this Quarterly Report on Form 10-Q contain forward-looking statements that reflect the current views of Universal Stainless & Alloy Products, Inc. (the Company) with respect to future events and financial performance. Statements looking forward in time, including statements regarding future growth, cost savings, expanded production capacity, broader product lines, greater capacity to meet customer quality reliability, price and delivery needs, enhanced competitive posture, effect of new accounting pronouncements and no material financial impact from litigation or contingencies are included in this Quarterly Report on Form 10-Q pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995.

The Company's actual results may be affected by a wide range of factors including future compliance with Section 404 of the Sarbanes-Oxley Act of 2002; the concentrated nature of the Company's customer base to date and the Company's dependence on its significant customers; the receipt, pricing and timing of future customer orders; changes in product mix; the limited number of raw material and energy suppliers and significant fluctuations that may occur in raw material and energy prices; the Company's reliance on the continuing operation of critical manufacturing equipment; risks associated with labor matters; the Company's ongoing requirement for continued compliance with safety and environmental regulations; and the ultimate outcome of the Company's current and future litigation matters. Many of these factors are not within the Company's control and involve known and unknown risks and uncertainties that may cause the Company's actual results in future periods to be materially different from any future performance suggested herein. Any unfavorable change in the foregoing or other factors could have a material adverse effect on the Company's business, financial condition and results of operations. Further, the Company operates in an industry sector where securities values may be volatile and may be influenced by economic and other factors beyond the Company's control.

| | DESCRIPTION | PAGE NO. |
|----------|---|-----------------|
| PART I. | <u>FINANCIAL INFORMATION</u> | |
| Item 1. | <u>Financial Statements</u> | |
| | <u>Consolidated Condensed Statements of Operations</u> | 3 |
| | <u>Consolidated Condensed Balance Sheets</u> | 4 |
| | <u>Consolidated Condensed Statements of Cash Flow</u> | 5 |
| | <u>Notes to the Unaudited Consolidated Condensed Financial Statements</u> | 6 |
| Item 2. | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 9 |
| Item 3. | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 13 |
| Item 4. | <u>Controls and Procedures</u> | 13 |
| PART II. | <u>OTHER INFORMATION</u> | |
| Item 1. | <u>Legal Proceedings</u> | 13 |
| Item 1A. | <u>Risk Factors</u> | 13 |
| Item 2. | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 13 |
| Item 3. | <u>Defaults Upon Senior Securities</u> | 13 |
| Item 4. | <u>Submission of Matters to a Vote of Security Holders</u> | 13 |
| Item 5. | <u>Other Information</u> | 13 |
| Item 6. | <u>Exhibits</u> | 14 |
| | <u>SIGNATURES</u> | 14 |
| | CERTIFICATIONS | |

Part I. FINANCIAL INFORMATION**Item 1. FINANCIAL STATEMENTS****UNIVERSAL STAINLESS & ALLOY PRODUCTS, INC.****CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS**

(Dollars in Thousands, Except Per Share Information)

(Unaudited)

| | For the Three-month period ended March 31, | |
|---|--|-----------|
| | 2008 | 2007 |
| Net sales | \$ 56,845 | \$ 56,239 |
| Cost of products sold | 46,779 | 43,020 |
| Selling and administrative expenses | 3,075 | 2,554 |
| Operating income | 6,991 | 10,665 |
| Interest expense | (28) | (227) |
| Other income | 87 | 4 |
| Income before taxes | 7,050 | 10,442 |
| Income tax provision | 2,327 | 3,655 |
| Net income | \$ 4,723 | \$ 6,787 |
| Earnings per common share Basic | \$ 0.71 | \$ 1.03 |
| Earnings per common share Diluted | \$ 0.70 | \$ 1.00 |
| Weighted-average shares of Common Stock outstanding | | |
| Basic | 6,663,213 | 6,621,307 |
| Diluted | 6,771,482 | 6,761,157 |

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

UNIVERSAL STAINLESS & ALLOY PRODUCTS, INC.

CONSOLIDATED CONDENSED BALANCE SHEETS

(Dollars in Thousands)

| | March 31, 2008 | December 31, 2007 |
|---|-------------------|---|
| | (Unaudited) | (Derived from audited statements) |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 10,795 | \$ 10,648 |
| Accounts receivable (less allowance for doubtful accounts of \$350 and \$311, respectively) | 34,675 | 27,501 |
| Inventory | 65,535 | 65,572 |
| Deferred taxes | 2,358 | 2,683 |
| Other current assets | 2,442 | 2,854 |
| Total current assets | 115,805 | 109,258 |
| Property, plant and equipment, net | 56,069 | 54,271 |
| Other assets | 925 | 767 |
| Total assets | \$ 172,799 | \$ 164,296 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities | | |
| Trade accounts payable | \$ 14,750 | \$ 13,983 |
| Outstanding checks in excess of bank balance | 4,804 | 2,064 |
| Current portion of long-term debt | 389 | 383 |
| Accrued employment costs | 3,638 | 5,307 |
| Accrued income tax | 2,145 | 330 |
| Other current liabilities | 971 | 1,270 |
| Total current liabilities | 26,697 | 23,337 |
| Long-term debt | 1,348 | 1,453 |
| Deferred taxes | 9,844 | 9,904 |
| Total liabilities | 37,889 | 34,694 |
| Commitments and contingencies | | |
| Stockholders equity | | |
| Senior Preferred Stock, par value \$0.001 per share; 1,980,000 shares authorized; 0 shares issued and outstanding | | |
| Common Stock, par value \$0.001 per share; 10,000,000 shares authorized; 6,954,794 and 6,930,294 shares issued | 7 | 7 |
| Additional paid-in capital | 35,697 | 35,112 |
| Retained earnings | 100,865 | 96,142 |
| Treasury Stock at cost; 270,795 common shares held | (1,659) | (1,659) |
| Total stockholders equity | 134,910 | 129,602 |
| Total liabilities and stockholders equity | \$ 172,799 | \$ 164,296 |

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

UNIVERSAL STAINLESS & ALLOY PRODUCTS, INC.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOW

(Dollars in Thousands)

(Unaudited)

| | For the | |
|--|---------------------------------------|----------|
| | Three-month period ended March 31, | |
| | 2008 | 2007 |
| Cash flow from operating activities: | | |
| Net income | \$ 4,723 | \$ 6,787 |
| Adjustments to reconcile to net cash provided by operating activities: | | |
| Depreciation and amortization | 982 | 899 |
| Loss on retirement of fixed assets | 286 | |
| Deferred income tax | 91 | 113 |
| Stock-based compensation expense | 195 | 100 |
| Tax benefit from share-based payment arrangements | (183) | (799) |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | (7,174) | (3,609) |
| Inventory | 37 | (5,621) |
| Trade accounts payable | 767 | 2,071 |
| Accrued income tax payable | 1,815 | 1,814 |
| Accrued employment costs | (1,669) | (522) |
| Other, net | 338 | 1,302 |
| Net cash provided by operating activities | 208 | 2,535 |
| Cash flow from investing activities: | | |
| Capital expenditures | (3,092) | (1,253) |
| Net cash used in investing activities | (3,092) | (1,253) |
| Cash flows from financing activities: | | |
| Revolving line of credit net repayments | | (5,149) |
| Long-term debt repayments | (99) | (589) |
| Net change in outstanding checks in excess of bank balance | 2,740 | 899 |
| Proceeds from issuance of common stock | 207 | 731 |
| Tax benefit from share-based payment arrangements | 183 | 799 |
| Net cash provided by (used in) financing activities | 3,031 | (3,309) |
| Net increase (decrease) in cash and cash equivalents | 147 | (2,027) |
| Cash and cash equivalents at beginning of period | 10,648 | 2,909 |
| Cash and cash equivalents at end of period | \$ 10,795 | \$ 882 |
| Supplemental disclosure of cash flow information: | | |
| Interest paid | \$ 62 | \$ 255 |
| Income taxes paid, net of refunds received | \$ 147 | \$ 1,047 |

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

UNIVERSAL STAINLESS & ALLOY PRODUCTS, INC.

NOTES TO THE UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Note 1 Basis of Presentation

The accompanying unaudited consolidated condensed financial statements of operations for the three-month periods ended March 31, 2008 and 2007, balance sheets as of March 31, 2008 and December 31, 2007, and statements of cash flows for the three-month periods ended March 31, 2008 and 2007, have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading. Accordingly, these statements should be read in conjunction with the audited financial statements, and notes thereto, as of and for the year ended December 31, 2007 included in the Company's Annual Report on Form 10-K. In the opinion of management, the accompanying unaudited, consolidated condensed financial statements contain all adjustments, all of which were of a normal, recurring nature, necessary to present fairly, in all material respects, the consolidated financial position at March 31, 2008 and December 31, 2007 and the consolidated results of operations and of cash flows for the three-month periods ended March 31, 2008 and 2007, and are not necessarily indicative of the results to be expected for the full year.

Certain prior year amounts have been reclassified to conform to the 2008 presentation.

Note 2 Common Stock

The reconciliation of the weighted-average number of shares of Common Stock outstanding utilized for the earnings per common share computations is as follows:

| | For the Three-month period ended March 31, | |
|--|---|-----------|
| | 2008 | 2007 |
| Weighted-average number of shares of Common Stock outstanding | 6,663,213 | 6,621,307 |
| Effect of dilutive securities | 108,269 | 139,850 |
| Weighted-average number of shares of Common Stock outstanding, as adjusted | 6,771,482 | 6,761,157 |

Note 3 Inventory

The major classes of inventory are as follows:

| <i>(dollars in thousands)</i> | March 31, 2008 | December 31, 2007 |
|---|-------------------|----------------------|
| Raw materials and supplies | \$ 11,641 | \$ 8,309 |
| Semi-finished and finished steel products | 51,786 | 55,404 |
| Operating materials | 2,108 | 1,859 |
| Total inventory | \$ 65,535 | \$ 65,572 |

Note 4 Property, Plant and Equipment

Property, plant and equipment consists of the following:

| <i>(dollars in thousands)</i> | March 31, 2008 | December 31, 2007 |
|------------------------------------|-------------------|----------------------|
| Land and land improvements | \$ 2,298 | \$ 2,208 |
| Buildings | 10,647 | 10,371 |
| Machinery and equipment | 68,985 | 66,432 |
| Construction in progress | 4,001 | 4,571 |
| | 85,931 | 83,582 |
| Accumulated depreciation | (29,862) | (29,311) |
| Property, plant and equipment, net | \$ 56,069 | \$ 54,271 |

Note 5 Long-Term Debt

The Company maintains a credit agreement with PNC Bank for a \$15.0 million revolving credit facility with a term expiring on June 30, 2009. There was no balance outstanding under the revolver at March 31, 2008 or December 31, 2007. The credit agreement included a term loan which the Company retired in December 2007. Interest on borrowings under the revolving credit facility is based on short-term market rates, which may be adjusted, based upon the Company maintaining certain financial ratios. PNC Bank also charges a commitment fee payable on the unused portion of the revolving credit facility of 0.25%, provided certain financial ratios are maintained. The Company is required to be in compliance with three financial covenants: a minimum leverage ratio, a minimum debt service ratio and a minimum tangible net worth. The Company was in compliance with all such covenants at March 31, 2008.

The Company maintains two separate loan agreements with the Commonwealth of Pennsylvania's Department of Commerce, aggregating \$600,000. A \$200,000 15-year loan bears interest at 5% per annum with the term ending in 2011 and a \$400,000 20-year loan bears interest at 6% per annum with the term ending in 2016. On February 14, 2002, Dunkirk Specialty Steel issued two ten-year, 5% interest-bearing notes payable to the New York Job Development Authority for the combined amount of \$3.0 million. The remaining unpaid balance of these government loans was \$1.7 million at March 31, 2008 and \$1.8 million at December 31, 2007.

Note 6 Commitments and Contingencies

From time to time, various lawsuits and claims have been or may be asserted against the Company relating to the conduct of our business, including routine litigation relating to commercial and employment matters. The ultimate cost and outcome of any litigation or claim cannot be predicted with certainty. Management does not believe, based on information presently available, that the ultimate outcome of any such pending matter is likely to have a material adverse effect on our financial condition or liquidity, although the resolution in any quarter of one or more of these matters may have a material adverse effect on our results of operations for that period.

At March 31, 2008, the Company maintains reserves that it believes are adequate for outstanding product claims and legal actions.

Note 7 Income Taxes

The tax rate used for interim periods is the estimated annual effective tax rate, based on the current estimate of full year results, except that taxes related to specific events, if any, are recorded in the interim period in which they occur.

The effective income tax rate in the three-month period ended March 31, 2008 was 33.0% as compared to 35.0% for the three-month period ended March 31, 2007. The effective income rate in the current period reflects a decrease in state income taxes and an increase in the Company's permanent tax deductions related to investment tax credits that will be generated from capital improvements made at the Dunkirk facility in 2008.

Note 7 Business Segments

The Company is comprised of two business segments: Universal Stainless & Alloy Products, which consists of the Bridgeville and Titusville facilities, and Dunkirk Specialty Steel, the Company's wholly-owned subsidiary located in Dunkirk, New York. The Universal Stainless & Alloy Products manufacturing process involves melting, remelting, treating and hot and cold rolling of semi-finished and finished specialty steels. Dunkirk Specialty Steel's manufacturing process involves hot rolling and finishing of specialty steel bar, rod and wire products. The segment data are as follows:

| <i>(dollars in thousands)</i> | For the Three-month period ended March 31, | |
|--------------------------------------|---|------------------|
| | 2008 | 2007 |
| Net sales: | | |
| Universal Stainless & Alloy Products | \$ 48,198 | \$ 48,165 |
| Dunkirk Specialty Steel | 20,050 | 20,440 |
| Intersegment | (11,403) | (12,366) |
| Consolidated net sales | \$ 56,845 | \$ 56,239 |
| Operating income: | | |
| Universal Stainless & Alloy Products | \$ 4,931 | \$ 7,199 |
| Dunkirk Specialty Steel | 2,785 | 3,821 |
| Intersegment | (725) | (355) |
| Consolidated operating income | \$ 6,991 | \$ 10,665 |

| <i>(dollars in thousands)</i> | For the Three-month period ended March 31, | |
|---|---|---------------|
| | 2008 | 2007 |
| Interest expense and other financing costs: | | |
| Universal Stainless & Alloy Products | \$ 7 | \$ 188 |
| Dunkirk Specialty Steel | 21 | 39 |
| Total interest expense and other financing costs | \$ 28 | \$ 227 |
| Other income | | |
| Universal Stainless & Alloy Products | \$ 57 | \$ 3 |
| Dunkirk Specialty Steel | 30 | 1 |
| Total other income | \$ 87 | \$ 4 |

| <i>(dollars in thousands)</i> | March 31, | December 31, |
|--------------------------------------|-------------------|---------------------|
| | 2008 | 2007 |
| Total assets: | | |
| Universal Stainless & Alloy Products | \$ 117,383 | \$ 110,669 |
| Dunkirk Specialty Steel | 38,669 | 35,983 |
| Corporate assets | 16,747 | 17,644 |
| | \$ 172,799 | \$ 164,296 |

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Results of Operations

An analysis of the Company's operations for the three-month periods ended March 31, 2008 and 2007 is as follows:

| <i>(dollars in thousands)</i> | For the | |
|-------------------------------------|---------------------------------------|-----------|
| | Three-month period ended March 31, | |
| | 2008 | 2007 |
| Net sales: | | |
| Stainless steel | \$ 42,028 | \$ 39,570 |
| Tool steel | 9,107 | 7,097 |
| High-strength low alloy steel | 4,011 | 6,234 |
| High-temperature alloy steel | 1,146 | 2,745 |
| Conversion services | 525 | 489 |
| Other | 28 | 104 |
| Total net sales | 56,845 | 56,239 |
| Cost of products sold | 46,779 | 43,020 |
| Selling and administrative expenses | 3,075 | 2,554 |
| Operating income | \$ 6,991 | \$ 10,665 |
| Tons Shipped | 11,767 | 11,157 |

Market Segment Information

| <i>(dollars in thousands)</i> | For the | |
|----------------------------------|---------------------------------------|-----------|
| | Three-month period ended March 31, | |
| | 2008 | 2007 |
| Net sales: | | |
| Service centers | \$ 29,234 | \$ 29,105 |
| Forgers | 9,018 | 12,574 |
| Rerollers | 11,239 | 7,192 |
| Original equipment manufacturers | 5,441 | 4,877 |
| Wire redrawers | 1,369 | 1,898 |
| Conversion services | 525 | 489 |
| Miscellaneous | 19 | 104 |
| Total net sales | \$ 56,845 | \$ 56,239 |

Three-month period ended March 31, 2008 as compared to the same period in 2007

Net sales for the three-month period ended March 31, 2008 increased \$606,000 as compared to the similar period in 2007. The increase reflects higher shipments of billet product to rerollers and tool steel plate product to service centers, offset by lower shipments of semi-finished products to forgers and finished bar, rod and wire products to service centers and wire redrawers. Lower raw material surcharges also impacted sales, led by a decrease in average nickel prices during the three-month period ended March 31, 2008 in comparison to the three-month period ended March 31, 2007.

Cost of products sold, as a percentage of net sales, was 82.3% and 76.5% for the three-month periods ended March 31, 2008 and 2007, respectively. The increase is primarily due to the change in mix of products shipped described above.

Edgar Filing: UNIVERSAL STAINLESS & ALLOY PRODUCTS INC - Form 10-Q

Selling and administrative expenses increased by \$521,000 in the three-month period ended March 31, 2008 as compared to the similar period in 2007. The increased cost primarily related to an increase in stock-based compensation expense, additional costs incurred as a result of complying with the Sarbanes-Oxley Section 404 requirements for the first time as of December 31, 2007, higher legal fees resulting from the Company's defense of a contractor litigation matter and the recognition of a reserve for a product claim matter.

Interest expense and other financing costs decreased from \$227,000 for the three-month period ended March 31, 2007 to \$28,000 for the three-month period ended March 31, 2008 primarily due to not having to borrow on the Company's revolving credit facility since August 2007 and the December 2007 retirement of the PNC Term Loan.

The effective income tax rate in the three-month period ended March 31, 2008 was 33.0% as compared to 35.0% for the three-month period ended March 31, 2007. The effective income rate in the current period reflects a decrease in state income taxes and an increase in the Company's permanent tax deductions related to investment tax credits that will be generated from capital improvements made at the Dunkirk facility in 2008.

Business Segment Results

An analysis of the net sales and operating income for the reportable segments for the three-month periods ended March 31, 2008 and 2007 is as follows:

Universal Stainless & Alloy Products Segment

| <i>(dollars in thousands)</i> | For the Three-month period ended March 31, | |
|-------------------------------------|---|-------------|
| | 2008 | 2007 |
| Net sales: | | |
| Stainless steel | \$ 27,310 | \$ 24,996 |
| Tool steel | 8,424 | 6,159 |
| High-strength low alloy steel | 1,113 | 4,000 |
| High-temperature alloy steel | 569 | 1,230 |
| Conversion services | 357 | 327 |
| Other | 10 | 86 |
| | 37,783 | 36,798 |
| Intersegment | 10,415 | 11,367 |
| Total net sales | 48,198 | 48,165 |
| Material cost of sales | 23,339 | 21,231 |
| Operation cost of sales | 17,790 | 18,017 |
| Selling and administrative expenses | 2,138 | 1,718 |
| Operating income | \$ 4,931 | \$ 7,199 |

Net sales for the three-month period ended March 31, 2008 for this segment, which consists of the Bridgeville and Titusville facilities, were equivalent to the same period a year ago. Higher shipments of billet product to rerollers and tool steel plate product to service centers, more than offset lower shipments of semi-finished products to forgers and finished bar products to service centers. Lower raw material surcharges also impacted sales, led by a decrease in average nickel prices during the three-month period ended March 31, 2008 in comparison to the three-month period ended March 31, 2007.

Operating income for the 2008 first quarter decreased \$2.3 million, or 31.5%, from first quarter 2007 primarily due to the change in mix of products shipped described above.

Dunkirk Specialty Steel Segment

| <i>(dollars in thousands)</i> | For the | |
|-------------------------------------|---------------------------------------|-----------|
| | Three-month period ended March 31, | |
| | 2008 | 2007 |
| Net sales: | | |
| Stainless steel | \$ 14,718 | \$ 14,574 |
| Tool steel | 683 | 938 |
| High-strength low alloy steel | 2,898 | 2,234 |
| High-temperature alloy steel | 577 | 1,515 |
| Conversion services | 168 | 162 |
| Other | 18 | 18 |
| | 19,062 | 19,441 |
| Intersegment | 988 | 999 |
| Total net sales | 20,050 | 20,440 |
| Material cost of sales | 11,839 | 11,196 |
| Operation cost of sales | 4,489 | 4,587 |
| Selling and administrative expenses | 937 | 836 |
| Operating income | \$ 2,785 | \$ 3,821 |

Net sales for the three-month period ended March 31, 2008 matched the same period a year ago. Higher shipments of finished bar products more than offset lower shipments of rod and wire products. Lower raw material surcharges also impacted sales, led by a decrease in average nickel prices during the three-month period ended March 31, 2008 in comparison to the three-month period ended March 31, 2007.

Operating income for the three-month period ended March 31, 2008 decreased \$1.0 million, or 27.1%, in comparison to the three-month period ended March 31, 2007 primarily due to the impact from nickel price fluctuations. For this segment, raw material surcharges are primarily assessed at the time of shipment while the material cost of those shipments is determined at the time of order entry. Based upon the timing of surcharges assessed, the Company estimates Dunkirk generated an operating income benefit of \$1.2 million for the three-month period ended March 31, 2007 in comparison to an operating income charge of \$157,000 for the three-month period ended March 31, 2008.

Liquidity and Capital Resources

The Company has financed its operating activities through cash on hand at the beginning of the period. At March 31, 2008, working capital approximated \$89.1 million as compared to \$85.9 million at December 31, 2007. The increase in accounts receivable and the decrease in accrued employment costs more than offset the increases in accounts payable and other current liabilities. Accounts receivable increased \$7.2 million as a result of increased sales for the three-month period ended March 31, 2008 in comparison to the three-month period ended December 31, 2007. The decrease in accrued employment costs is primarily due to the payment of \$2.4 million in profit sharing earned by the Company's employees in 2007. The increase in accounts payable and other current liabilities is related to the timing of raw material receipts and higher income taxes payable, respectively. The ratio of current assets to current liabilities decreased from 4.7:1 at December 31, 2007 to 4.3:1 at March 31, 2008. The debt to total capitalization ratio was 1.3% at March 31, 2008 and 1.4% at December 31, 2007.

Cash received from sales activities of \$49.2 million and \$52.9 million represents the primary source of cash from operations for the three-month periods ended March 31, 2008 and 2007, respectively. The primary uses of cash follow:

| <i>(dollars in thousands)</i> | For the | |
|-------------------------------|---------------------------------------|-----------|
| | Three-month period ended March 31, | |
| | 2008 | 2007 |
| Raw material purchases | \$ 24,321 | \$ 24,127 |

Edgar Filing: UNIVERSAL STAINLESS & ALLOY PRODUCTS INC - Form 10-Q

| | | |
|--------------------|-----------|-----------|
| Employment costs | 11,844 | 10,745 |
| Utilities | 5,112 | 5,127 |
| Other | 7,691 | 10,373 |
| Total uses of cash | \$ 48,968 | \$ 50,372 |

Cash used in raw material purchases increased in 2008 in comparison to 2007 primarily due to quantity of purchased materials offset by lower unit transaction costs. The Company continuously monitors market price fluctuations of its key raw materials. The following table reflects the average market values per pound for selected months during the last 15-month period.

| | March 2008 | December 2007 | March 2007 | December 2006 |
|--------------|---------------|------------------|---------------|------------------|
| Nickel | \$ 14.16 | \$ 11.79 | \$ 21.01 | \$ 15.68 |
| Chrome | \$ 2.11 | \$ 1.66 | \$ 0.81 | \$ 0.64 |
| Molybdenum | \$ 33.78 | \$ 32.54 | \$ 28.15 | \$ 24.87 |
| Carbon Scrap | \$ 0.18 | \$ 0.14 | \$ 0.17 | \$ 0.10 |

The market values for these raw materials continue to fluctuate based on supply and demand, market disruptions, and other factors. The Company maintains sales price surcharge mechanisms, priced at time of shipment, to mitigate the risk of raw material cost fluctuations. There can be no assurance that these sales price adjustments will completely offset the Company's raw material and energy costs.

Increased employment costs are primarily due to higher production volumes, increased payout under the Company's profit sharing plan, and higher employee-related insurance costs. The decrease in other uses of cash, the majority of which is cash for outside conversion services, production supplies, plant maintenance and freight is attributable to lower conversion and freight expenditures. In addition, payments for income taxes in the 2008 first quarter decreased by \$900,000 from the same period in 2007, principally due to timing of the federal estimated payment.

The Company had capital expenditures for the first quarter 2008 of \$3.1 million, compared with \$1.3 million for the same period in 2007. The 2008 expenditures were primarily for Bridgeville plant improvements. Most of the 2007 expenditures were used to refurbish and equip an office building at the Bridgeville Facility that now represents the Company's corporate office.

The Company maintains a credit agreement with PNC Bank for a \$15.0 million revolving credit facility with the term expiring June 30, 2009. At March 31, 2008, the Company had all of its \$15.0 million revolving line of credit with PNC Bank available for borrowings. The Company is in compliance with its covenants as of March 31, 2008.

The Company does not maintain off-balance sheet arrangements other than operating leases nor does it participate in non-exchange traded contracts requiring fair value accounting treatment or material related party transaction arrangements.

The Company anticipates that it will fund its 2008 working capital requirements and its capital expenditures primarily from funds generated from operations, borrowings and stock issuances resulting from the exercise of outstanding stock options. Financing of the Company's long-term liquidity requirements, including capital expenditures, is expected from a combination of internally generated funds, borrowings, stock issuance or other sources of external financing, if needed.

Critical Accounting Policies

Revenue recognition is the most critical accounting policy of the Company. Revenue from the sale of products is recognized when both risk of loss and title have transferred to the customer, which in most cases coincides with shipment of the related products, and collection is reasonably assured. The Company manufactures specialty steel product to customer purchase order specifications and in recognition of requirements for product acceptance. Material certification forms are executed, indicating compliance with the customer purchase orders, before the specialty steel products are packed and shipped to the customer. Occasionally customers request that the packed products be held at the Company's facility beyond the stated shipment date. In these situations, the Company receives written confirmation of the request, acknowledgement that title has passed to the customer and that normal payment terms apply. The impact on revenue was less than 1% of net sales in each period presented.

Revenue from conversion services is recognized when the performance of the service is complete. Invoiced shipping and handling costs are also accounted for as revenue. Customer claims are accounted for primarily as a reduction to gross sales after the matter has been researched and an acceptable resolution has been reached.

In addition, management constantly monitors the ability to collect its unpaid sales invoices and the valuation of its inventory. The allowance for doubtful accounts includes specific reserves for the value of outstanding invoices issued to customers currently operating under the protection of the federal bankruptcy law and other amounts that are deemed potentially not collectible along with a reserve equal to 15% of 90-day or older balances not specifically reserved. However, the total reserve will not be less than 1% of trade accounts receivable. An inventory reserve is provided for material on hand for which management believes cost exceeds fair market value and for material on hand for more than one year not assigned to a specific customer order.

Long-lived assets are reviewed for impairment annually by each operating facility. An impairment write-down will be recognized whenever events or changes in circumstances indicate that the carrying value may not be recoverable through estimated future undiscounted cash flows.

Based on management's assessment of the carrying values of such long-lived assets, no impairment reserve had been deemed necessary as of March 31, 2008 and 2007. Retirements and disposals are removed from cost and accumulated depreciation accounts, with the gain or loss reflected in operating income.

In addition, management assesses the need to record a valuation allowance to reduce deferred tax assets to the amount that is more likely than not to be realized. The Company believes it will generate sufficient income in addition to taxable income generated from the reversal of its temporary differences to utilize the deferred tax assets recorded at March 31, 2008.

2008 Outlook

These are forward-looking statements for purposes of the Private Securities Litigation Reform Act of 1995 and actual results may vary.

The Company estimates that second quarter 2008 sales will range from \$55 to \$60 million and that diluted EPS will range from \$0.70 to \$0.75. This compares with sales of \$62.1 million and diluted EPS of \$0.87 in the second quarter of 2007. The following factors were considered in developing these estimates:

The Company's total backlog at March 31, 2008 approximated \$88 million compared to \$85 million at December 31, 2007.

Sales from the Dunkirk Specialty Steel segment are expected to approximate \$20 million in the second quarter of 2008.

The estimated cost to be recognized in the 2008 second quarter attributable to the relocation of the round bar finishing facility from Bridgeville to Dunkirk is \$200,000, equivalent to \$0.02 per diluted share.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has reviewed the status of its market risk and believes there are no significant changes from that disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, except as provided in this Form 10-Q in Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 4. CONTROLS AND PROCEDURES

The Company's management, including the Company's President and Chief Executive Officer and the Vice President of Finance, Chief Financial Officer and Treasurer, performed an evaluation of the effectiveness of the Company's disclosure controls and procedures. Based on that evaluation, the Company's President and Chief Executive Officer and the Vice President of Finance, Chief Financial Officer and Treasurer concluded that, as of the end of the period covered by this quarterly report, the Company's disclosure controls and procedures are effective in the timely identification of material information required to be included in the Company's periodic filings with the SEC. During the quarter ended March 31, 2008, there were no changes in the Company's internal control over financial reporting which have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

There are no material changes from the legal proceedings disclosed in Item 3. of the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

Item 1A. RISK FACTORS

Edgar Filing: UNIVERSAL STAINLESS & ALLOY PRODUCTS INC - Form 10-Q

There are no material changes from the risk factors disclosed in Item 1A. of the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

Exhibits

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)

SIGNATURES

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

May 8, 2008

/s/ Dennis M. Oates
Dennis M. Oates
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Richard M. Ubinger
Richard M. Ubinger
Vice President of Finance, Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)