

FRIEDMAN INDUSTRIES INC  
Form 10-Q  
February 14, 2019

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2018**

**OR**

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

**FROM THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

**COMMISSION FILE NUMBER 1-7521**

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Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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

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

At February 14, 2019, the number of shares outstanding of the issuer's only class of stock was 7,009,444 shares of Common Stock.

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**Part I — FINANCIAL INFORMATION****Item 1. Financial Statements**

FRIEDMAN INDUSTRIES, INCORPORATED

**CONDENSED CONSOLIDATED BALANCE SHEETS — UNAUDITED**

	<b>December 31, 2018</b>	<b>March 31, 2018  As Adjusted</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash	\$2,575,269	\$4,052,582
Accounts receivable, net of allowances for bad debts and cash discounts of \$21,052 December 31, 2018 and March 31, 2018	17,207,574	17,458,289
Inventories	59,415,035	45,329,434
Other	684,237	429,101
<b>TOTAL CURRENT ASSETS</b>	<b>79,882,115</b>	<b>67,269,406</b>
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Land	1,452,799	1,452,799
Buildings and yard improvements	8,816,631	8,710,958
Machinery and equipment	39,824,953	39,282,944
Less accumulated depreciation	(36,353,488)	(35,280,700)
	13,740,895	14,166,001
<b>OTHER ASSETS:</b>		
Cash value of officers' life insurance and other assets	236,725	217,900
<b>TOTAL ASSETS</b>	<b>\$93,859,735</b>	<b>\$81,653,307</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable and accrued expenses	\$16,727,511	\$10,233,431
Income taxes payable	175,845	—
Dividends payable	420,567	140,189
Contribution to retirement plan	200,000	45,000
Employee compensation and related expenses	334,082	612,015
<b>TOTAL CURRENT LIABILITIES</b>	<b>17,858,005</b>	<b>11,030,635</b>

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POSTRETIREMENT BENEFITS OTHER THAN PENSIONS	197,347	175,056
DEFERRED INCOME TAX LIABILITY	1,798,048	1,872,166
TOTAL LIABILITIES	19,853,400	13,077,857
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Common stock, par value \$1:		
Authorized shares — 10,000,000		
Issued shares — 8,185,160 at December 31 and March 31, 2018	8,185,160	8,185,160
Additional paid-in capital	29,371,594	29,154,874
Treasury stock at cost (1,175,716 shares at December 31 and March 31, 2018)	(5,475,964 )	(5,475,964 )
Retained earnings	41,925,545	36,711,380
TOTAL STOCKHOLDERS' EQUITY	74,006,335	68,575,450
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$93,859,735	\$81,653,307

## FRIEDMAN INDUSTRIES, INCORPORATED

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS — UNAUDITED

	Three months ended December 31,		Nine months ended December 31,	
	2018	2017	2018	2017
		As Adjusted		As Adjusted
Net sales	\$43,326,080	\$28,033,521	\$144,951,427	\$77,194,500
Costs and expenses				
Costs of goods sold	41,395,596	26,308,987	132,883,924	72,426,245
General, selling and administrative costs	1,054,100	999,220	3,836,279	2,962,139
Interest expense	1,792	8,451	17,545	8,451
	42,451,488	27,316,658	136,737,748	75,396,835
Interest and other income	(6,275 )	(4,375 )	(75,325 )	(13,125 )
Earnings before income taxes	880,867	721,238	8,289,004	1,810,790
Provision for (benefit from) income taxes:				
Current	282,365	63,510	2,097,540	79,150
Deferred	(66,271 )	496,457	(74,118 )	810,705
	216,094	559,967	2,023,422	889,855
Net earnings	\$664,773	\$161,271	\$6,265,582	\$920,935
Weighted average number of common shares outstanding:				
Basic	7,009,444	7,009,444	7,009,444	7,009,444
Diluted	7,009,444	7,009,444	7,009,444	7,009,444
Net earnings per share:				
Basic	\$0.09	\$0.02	\$0.89	\$0.13
Diluted	\$0.09	\$0.02	\$0.89	\$0.13
Cash dividends declared per common share	\$0.06	\$0.01	\$0.15	\$0.03

## FRIEDMAN INDUSTRIES, INCORPORATED

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS — UNAUDITED**

	<b>Nine Months Ended December 31</b>	
	<b>2018</b>	<b>2017</b>
		<b>As Adjusted</b>
<b>OPERATING ACTIVITIES</b>		
Net earnings	\$6,265,582	\$920,935
Adjustments to reconcile net earnings to cash used in operating activities:		
Depreciation	1,072,788	996,139
Deferred taxes	(74,118 )	810,705
Compensation expense for restricted stock	216,720	216,720
Provision for postretirement benefits	22,291	5,159
Decrease (increase) in operating assets:		
Accounts receivable, net	250,715	1,884,870
Inventories	(14,085,601)	(11,939,413)
Federal income taxes recoverable	—	46,453
Other	(255,136 )	(267,036 )
Increase (decrease) in operating liabilities:		
Accounts payable and accrued expenses	6,494,080	4,571,796
Income taxes payable	175,845	32,698
Contribution to retirement plan	155,000	120,000
Employee compensation and related expenses	(277,933 )	11,546
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(39,767 )</b>	<b>(2,589,428 )</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of property, plant and equipment	(647,682 )	(275,056 )
Change in cash surrender value of officers' life insurance	(18,825 )	(13,125 )
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(666,507 )</b>	<b>(288,181 )</b>
<b>FINANCING ACTIVITIES</b>		
Borrowings under revolving line of credit	—	3,750,000
Cash dividends paid	(771,039 )	(210,283 )
<b>NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<b>(771,039 )</b>	<b>3,539,717</b>
<b>INCREASE (DECREASE) IN CASH</b>	<b>(1,477,313 )</b>	<b>662,108</b>
Cash at beginning of period	4,052,582	1,461,695
<b>CASH AT END OF PERIOD</b>	<b>\$2,575,269</b>	<b>\$2,123,803</b>





## FRIEDMAN INDUSTRIES, INCORPORATED

**CONDENSED NOTES TO QUARTERLY REPORT — UNAUDITED**

## NOTE A — BASIS OF PRESENTATION

The accompanying unaudited, condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. For further information, refer to the consolidated financial statements and footnotes of Friedman Industries, Incorporated (the “Company”) included in its annual report on Form 10-K for the year ended March 31, 2018.

## NOTE B — CHANGE IN ACCOUNTING PRINCIPLE

Effective April 1, 2018, the Company changed its method for valuing prime coil inventory of the coil segment from the last-in, first-out (“LIFO”) method to the average cost method. The effects of the change in accounting principle from LIFO to average cost have been retrospectively applied to all prior periods presented in all sections of this quarterly report on Form 10-Q. The Company believes the average cost method is preferable as it more closely resembles the physical flow of our inventory, it better matches revenues with expenses and it aligns with how we internally manage our business. As a result of the retrospective application of the change in accounting principle, certain financial statement line items in the Company’s consolidated balance sheet as of March 31, 2018, its consolidated statement of operations for the three and nine months ended December 31, 2017 and its consolidated statement of cash flows for the nine months ended December 31, 2017 were adjusted as presented in the table below. In addition, retained earnings as of April 1, 2017 increased \$4,418,318 as a result of the change in accounting principle.

	<b>As Originally Reported</b>	<b>Effect of Change</b>	<b>As Adjusted</b>
<b>Consolidated Statement of Operations, Three Months Ended December 31, 2017</b>			
Cost of goods sold	26,364,387	(55,400 )	26,308,987
Income tax provision	542,909	17,058	559,967

Net earnings	122,929	38,342	161,271
Net earnings per share:			
Basic	0.02	-	0.02
Diluted	0.02	-	0.02

**Consolidated Statement of Operations, Nine Months Ended December 31, 2017**

Cost of goods sold	72,884,773	(458,528 )	72,426,245
Income tax provision	748,674	141,181	889,855
Net earnings	603,588	317,347	920,935

Net earnings per share:			
Basic	0.09	0.04	0.13
Diluted	0.09	0.04	0.13

**Consolidated Statement of Cash Flows, Nine Months Ended December 31, 2017**

Net earnings	603,588	317,347	920,935
Change in inventories	(11,480,885)	(458,528 )	(11,939,413)
Change in deferred income taxes	702,222	108,483	810,705
Change in income taxes payable	-	32,698	32,698

**Consolidated Balance Sheet, as of March 31, 2018**

Inventories	38,039,332	7,290,102	45,329,434
Deferred income tax liability	103,198	1,768,968	1,872,166
Retained earnings	31,190,246	5,521,134	36,711,380

The following table shows the effect of the change in accounting principle from LIFO to average cost on the three and nine months ended December 31, 2018:

	As Computed  Under LIFO	As Computed  Under Average Cost	Effect of  Change
<b>Consolidated Statement of Operations, Three Months Ended December 31, 2018</b>			
Earnings before income taxes	2,233,044	880,867	(1,352,177)
Income tax provision	545,478	216,094	(329,384 )
Net earnings	1,687,567	664,773	(1,022,794)
Net earnings per share:			
Basic	0.24	0.09	(0.15 )
Diluted	0.24	0.09	(0.15 )
<b>Consolidated Statement of Operations, Nine Months Ended December 31, 2018</b>			
Earnings before income taxes	5,782,409	8,289,004	2,506,595
Income tax provision	1,412,796	2,023,422	610,626
Net earnings	4,369,614	6,265,582	1,895,968
Net earnings per share:			
Basic	0.62	0.89	0.27
Diluted	0.62	0.89	0.27

#### NOTE C — NEW ACCOUNTING STANDARDS

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). ASU 2014-09 states that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This update also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments, and assets recognized from costs incurred to obtain or fulfill a contract. The update supersedes prior revenue recognition guidance, including industry-specific guidance. Effective April 1, 2018, the Company adopted the new standard through the modified retrospective method applied to those contracts that were not completed as of April 1, 2018 and those contracts initiated on or after April 1, 2018. Results for reporting periods beginning on or after April 1, 2018 are presented under the new standard, while prior period

amounts are unadjusted and reported in accordance with historic accounting under the prior guidance. The modified retrospective method requires that the cumulative effect of initially applying the new guidance be recorded as an adjustment to the opening balance of retained earnings in the condensed consolidated balance sheet. The adoption of this new accounting guidance did not have an impact on any prior period earnings and no adjustment was recorded to the opening retained earnings balance as of April 1, 2018. The adoption did not have a financial statement impact to the Company but did result in expanded disclosures which are provided in Note H.

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 eliminates the diversity in practice related to the classification of certain cash receipts and payments in the statement of cash flows by adding or clarifying guidance on eight specific cash flow issues. The Company adopted this new guidance effective April 1, 2018. The adoption of this new guidance did not have a material impact on the Company’s consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (“ASU 2016-02”). ASU 2016-02 establishes a new lease accounting standard that requires lessees to recognize a right of use asset and related lease liability for most leases having lease terms of more than 12 months. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases. This new guidance is effective for annual and interim periods beginning after December 15, 2018, but can be early adopted. The Company is evaluating the impact that adoption of the provisions of ASU 2016-02 will have on its consolidated financial statements but does not expect a material impact.

## NOTE D — INVENTORIES

Inventories consist of prime coil, non-standard coil and tubular materials. Prime coil inventory consists primarily of raw materials, non-standard coil inventory consists primarily of raw materials and tubular inventory consists of both raw materials and finished goods. Effective April 1, 2018, the Company changed the inventory valuation method of its prime coil inventory from the LIFO method to the average cost method. Prime coil inventory value for both periods presented in the table below are based on average cost valuation. Cost for non-standard coil inventory is determined using the specific identification method. Cost for tubular inventory is determined using the average cost method. All inventories are valued at the lower of cost or net realizable value.

A summary of inventory values by product group follows:

	<b>December 31, 2018</b>	<b>March 31, 2018</b>
		<b>As Adjusted</b>
Prime Coil Inventory	\$32,052,655	\$14,185,858
Non-Standard Coil Inventory	2,353,592	2,971,324
Tubular Raw Material	8,127,972	6,734,076
Tubular Finished Goods	16,880,816	21,438,176
	<b>\$59,415,035</b>	<b>\$45,329,434</b>

Tubular raw material inventory consists of hot-rolled steel coils that the Company will manufacture into pipe. Tubular finished goods inventory consists of pipe the Company has manufactured and new mill reject pipe that the Company purchases from U.S. Steel Tubular Products, Inc. At December 31, 2018, the Company carried quantities of mill reject pipe on hand that exceeded the sales volume for fiscal year ended March 31, 2018. Based on improved market conditions and overall economic conditions as well as recent sales trends, the Company reasonably expects the sales volume for the future twelve month period to approximate or at least be a substantial portion of the December 31, 2018 quantity on hand, hence current classification of this inventory on the Company's balance sheet. The Company's projections are subject to significant estimates which may be different from actual results.

## NOTE E — DEBT

On December 11, 2018, the Company's \$7,500,000 revolving line of credit facility expired. On December 12, 2018, the Company entered into a loan agreement for a \$5,000,000 revolving line of credit facility (the "Credit Facility") with Citizens National Bank, which changed names to VeraBank on January 14, 2019 (the "Bank"). The Credit Facility expires on December 12, 2019 and is collateralized by the Company's tubular segment accounts receivable and inventory. Borrowings under the credit facility bear interest at the Bank's prime rate minus 0.55% resulting in an applicable interest rate of 4.95% as of December 31, 2018. Interest payments on amounts advanced are due monthly and principal payments may be made at any time without penalty. All outstanding principal and accrued interest is due upon expiration of the Credit Facility. Access to funds under the Credit Facility is subject to a borrowing base requirement. The borrowing base is calculated as 80% of eligible tubular segment accounts receivable plus 40% of eligible tubular segment inventory. The total amount contributed to the borrowing base by eligible inventory shall not exceed \$3,000,000. At December 31, 2018 and as of the filing date of this Form 10-Q, the borrowing base calculations would allow the Company access to the full \$5,000,000 available under the Credit Facility. The Credit Facility contains financial covenants that require the Company to not permit: (1) total shareholders' equity to be less than \$50.0 million at any time, (2) total liabilities to exceed 50% of total shareholders' equity at any time and (3) debt service coverage ratio, measured as of the end of each calendar quarter, to be less than 2.00 to 1.00. The debt service coverage ratio is calculated on a trailing twelve month period as the ratio of earnings before interest, taxes, depreciation and amortization (EBITDA) to the sum of interest expense for such period, scheduled principal payments for such period on all indebtedness for money borrowed and capital leases, and the aggregate amount payable during such period under any operating leases. At December 31, 2018 and as of the filing date of this Form 10-Q, the Company had no borrowings outstanding under the Credit Facility.

#### NOTE F — STOCK BASED COMPENSATION

The Company maintains the Friedman Industries, Incorporated 2016 Restricted Stock Plan (the "Plan"). The Plan is administered by the Compensation Committee (the "Committee") of the Board of Directors (the "Board") and continues indefinitely until terminated by the Board or until all shares allowed by the Plan have been awarded and earned. The aggregate number of shares of the Company's Common Stock eligible for award under the Plan is 500,000 shares. Subject to the terms and provisions of the Plan, the Committee may, from time to time, select the employees to whom awards will be granted and shall determine the amount and applicable restrictions of each award. Forfeitures are accounted for upon their occurrence.

As of December 31, 2018, the total number of restricted shares awarded under the Plan was 210,000 shares. All of the awarded shares have five year cliff vesting restrictions with vesting occurring on January 4, 2022. No other shares have been awarded under the Plan. The grant date fair value of the awarded shares is \$1,444,800 and is being recognized as compensation expense over the 60 month requisite service period. Compensation expense related to stock awards issued under the plan was \$72,240 in each of the quarters ended December 31, 2018 and December 31, 2017 and \$216,720 in each of the nine month periods ended December 31, 2018 and December 31, 2017.

## NOTE G — SEGMENT INFORMATION (in thousands)

	<b>Three Months Ended December 31, 2017</b>		<b>Nine Months Ended December 31, 2017</b>	
	<b>2018</b>	<b>As Adjusted</b>	<b>2018</b>	<b>As Adjusted</b>
Net sales				
Coil	\$28,731	\$ 22,410	\$94,688	\$ 60,547
Tubular	14,595	5,624	50,263	16,648
Total net sales	\$43,326	\$ 28,034	\$144,951	\$ 77,195
Operating profit (loss)				
Coil	\$744	\$ 1,233	\$5,847	\$ 2,942
Tubular	650	(53 )	4,348	261
Total operating profit	1,394	1,180	10,195	3,203
Corporate expenses	519	463	1,981	1,405
Interest & other income	(6 )	(4 )	(75 )	(13 )
Total earnings before taxes	\$881	\$ 721	\$8,289	\$ 1,811

	<b>December 31, 2018</b>	<b>March 31, 2018</b>
	<b>As Adjusted</b>	<b>As Adjusted</b>
Segment assets		
Coil	\$ 50,293	\$ 34,359
Tubular	40,708	43,010
	91,001	77,369
Corporate assets	2,859	4,284
	\$ 93,860	\$ 81,653

Corporate expenses reflect general and administrative expenses not directly associated with segment operations and consist primarily of corporate executive and accounting salaries, professional fees and services, bad debts, retirement plan contribution expense, corporate insurance expenses and office supplies. Corporate assets consist primarily of cash and the cash value of officers' life insurance.



NOTE H — REVENUE

Revenue is generated primarily from contracts to manufacture or process steel products. Most of the Company's revenue is generated by sales of material out of the Company's inventory but a portion of the Company's revenue is derived from processing of customer owned material. Generally, the Company's performance obligations are satisfied, control of our products is transferred, and revenue is recognized at a single point in time, when title transfers to our customer for product shipped or when services are provided. Revenues are recorded net of any sales incentives. Shipping and other transportation costs charged to customers are treated as fulfillment activities and are recorded in both revenue and cost of sales at the time control is transferred to the customer. Costs related to obtaining sales contracts are incidental and expensed when incurred. Because customers are invoiced at the time title transfers and the Company's rights to consideration are unconditional at that time, the Company does not maintain contract asset balances. Additionally, the Company does not maintain contract liability balances, as performance obligations are satisfied prior to customer payment for product. The Company offers industry standard payment terms.

The Company has two reportable segments: Coil and Tubular. Coil primarily generates revenue from temper passing and cutting to length hot-rolled steel coils. Coil segment revenue consists of three main product types: Prime Coil, Non-Standard Coil and Customer Owned Coil. Tubular primarily generates revenue from the manufacture, distribution and processing of steel pipe. Tubular segment revenue consists of three main product or service types: Manufactured Pipe, Mill Reject Pipe and Pipe Finishing Services. The following table disaggregates our revenue by product for each of our reportable business segments for the three and nine month periods ended December 31, 2018 and 2017, respectively:

	<b>Three Months Ended December 31,</b>		<b>Nine Months Ended December 31,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
<b>Coil Segment:</b>				
Prime Coil	25,074,965	17,862,981	79,426,810	47,598,283
Non-standard Coil	3,350,738	4,189,947	14,355,617	12,001,311
Customer Owned Coil	305,289	356,643	906,209	947,651
	28,730,992	22,409,571	94,688,636	60,547,245
<b>Tubular Segment:</b>				
Manufactured Pipe	10,767,166	4,144,506	35,936,762	10,467,228
Mill Reject Pipe	3,761,188	1,479,444	13,489,029	4,515,771
Pipe Finishing Services	66,734	-	837,000	1,664,256
	14,595,088	5,623,950	50,262,791	16,647,255

#### NOTE I — SUPPLEMENTAL CASH FLOW INFORMATION

The Company paid income taxes of approximately \$1,846,000 and \$8,000 in the nine months ended December 31, 2018 and 2017, respectively. The Company paid interest of \$17,545 in the nine months ended December 31, 2018. The Company paid no interest in the nine months ended December 31, 2017. Non-cash financing activities consisted of accrued dividends of \$1,051,417 and \$70,094 in the nine-month periods ended December 31, 2018 and 2017, respectively. In the nine months ended December 31, 2017, there were noncash transactions of \$385,000 for the transfer of ownership of life insurance policies from the Company to officers upon their retirement.

#### NOTE J — INCOME TAXES

For the nine months ended December 31, 2018, the Company recorded an income tax provision of \$2,023,422, or 24.4% of pre-tax income, compared to \$889,855, or 49.1% of pre-tax income, for the nine months ended December 31, 2017. The provision for the nine months ended December 31, 2017 has been adjusted by the retroactive application of the change in accounting principle disclosed in Note B.

On December 22, 2017, the U.S. government signed into law the Tax Cuts and Jobs Act (the “Tax Act”). The Tax Act, among other things, lowered the U.S. corporate income tax rate applicable to the Company from 34% to 21% effective January 1, 2018. For the nine months ended December 31, 2018, the Company’s effective tax rate differed from the corporate statutory rate due primarily to the inclusion of state tax expenses in the Company’s income tax provision. For the nine months ended December 31, 2017, the Company’s effective tax rate differed from the corporate statutory rate due primarily to the re-measurement of deferred tax assets and liabilities according to the Tax Act.

Also on December 22, 2017, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 (“SAB 118”) to address the application of U.S. GAAP in situations where a registrant does not have the necessary information available, prepared or analyzed in reasonable detail to complete the accounting for certain income tax effects of the Tax Act. SAB 118 allowed companies to record provisional estimates during a measurement period not extending beyond one year from the Tax Act enactment date. As of December 22, 2018, the Company has completed the accounting for all impacts of the Tax Act and there have been no changes to previously recorded amounts.

## **Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

### **Overview**

Friedman Industries, Incorporated is a manufacturer and processor of steel products and operates in two reportable segments; coil products and tubular products.

The coil product segment includes the operation of two hot-roll coil processing facilities; one in Hickman, Arkansas and the other in Decatur, Alabama. Each facility operates a temper mill and a cut-to-length line. The temper mill improves the flatness and surface qualities of the coils and the cut-to-length line levels the steel and cuts the coils into sheet and plate of prescribed lengths. Combined, the facilities are capable of cutting sheet and plate with thicknesses ranging from 14 gauge to ½” thick. The coil product segment sells its prime grade inventory under the Friedman Industries name but also maintains an inventory of non-standard coil products, consisting primarily of mill secondary and excess prime coils, which are sold through the Company’s XSCP division. The coil product segment also processes customer-owned coils on a fee basis. Effective April 1, 2018, the Company changed the inventory valuation method for the coil segment’s prime coil inventory from the LIFO method to the average cost method. The impact of this change in accounting principle to both the current fiscal year periods and, as applied retrospectively, to the comparable periods of the prior fiscal year are disclosed in Note B of the consolidated financial statements. Prior period information provided in this Management’s Discussion and Analysis has been updated to reflect the retrospective application of the change in accounting principle.



The tubular product segment consists of the Company's Texas Tubular Products division ("TTP") located in Lone Star, Texas. TTP operates two electric resistance welded pipe mills with a combined outside diameter ("OD") size range of 2 3/8" OD to 8 5/8" OD. Both pipe mills are American Petroleum Institute ("API") licensed to manufacture line pipe and oil country pipe and also manufacture pipe for structural purposes that meets other recognized industry standards. TTP has a pipe finishing facility that threads and couples oil country tubular goods and performs other services that are customary in the pipe finishing process. The pipe finishing facility is API licensed and focuses on threading semi-premium connections. TTP's inventory consists of raw materials and finished goods. Raw material inventory consists of hot-rolled steel coils that TTP will manufacture into pipe. Finished goods inventory consists of pipe TTP has manufactured and new mill reject pipe that TTP purchases from U.S. Steel Tubular Products, Inc. ("USS").

## Results of Operations

### *Nine Months Ended December 31, 2018 Compared to Nine Months Ended December 31, 2017*

During the nine months ended December 31, 2018 (the "2018 period"), sales, costs of goods sold and gross profit increased \$67,756,927, \$60,457,679 and \$7,299,248, respectively, from the comparable amounts recorded during the nine months ended December 31, 2017 (the "2017 period"). The increase in sales was related to both an increase in tons sold and an increase in the average per ton selling price. Tons sold increased approximately 53% from approximately 114,500 tons in the 2017 period to approximately 175,500 tons in the 2018 period. Discussion of the sales improvement is expanded upon at the segment level in the following paragraphs. Gross profit as a percentage of sales increased from approximately 6.2% in the 2017 period to approximately 8.3% in the 2018 period.

### *Coil Segment*

Coil product segment sales for the 2018 period totaled \$94,688,636 compared to \$60,547,245 for the 2017 period, representing a sales increase of \$34,141,391 or approximately 56%. For a more complete understanding of the average selling prices of goods sold, it is helpful to isolate sales generated from processing of customer owned material and sales generated from coil segment inventory. Sales generated from processing of customer owned material totaled \$906,209 for the 2018 period compared to \$947,651 for the 2017 period. Sales generated from coil segment inventory totaled \$93,782,427 for the 2018 period compared to \$59,599,594 for the 2017 period. The increase in coil segment sales was driven by an increase in tons shipped from inventory and an increase in the average selling price per ton for these shipments. Inventory tons sold increased from approximately 90,000 tons in the 2017 period to approximately 105,500 tons in the 2018 period. The average per ton selling price related to these shipments increased from approximately \$661 per ton in the 2017 period to approximately \$890 per ton in the 2018 period. The improved shipping volume for the 2018 period is attributable to increased demand among many of the segment's customers. Management believes the demand improvement was primarily related to the effects of the U.S. government's Section 232 steel trade actions, sustained improvement of the U.S. energy industry and the steel industry and U.S. economic conditions in general. Coil segment operations recorded operating profits of approximately \$5,847,000 and

\$2,942,000 in the 2018 and 2017 periods, respectively.

The Company's coil segment purchases its inventory from a limited number of suppliers. Loss of any of these suppliers could have a material adverse effect on the Company's business.

### *Tubular Segment*

Tubular product segment sales for the 2018 period totaled \$50,262,791 compared to \$16,647,255 for the 2017 period, representing a sales increase of \$33,615,536 or approximately 202%. For a more complete understanding of the average selling prices of goods sold, it is helpful to isolate sales generated from the finishing of customer owned pipe and sales generated from tubular segment inventory. Sales generated from finishing of customer owned pipe totaled \$837,000 for the 2018 period compared to \$1,664,256 for the 2017 period. Sales generated from tubular segment inventory totaled \$49,425,791 for the 2018 period compared to \$14,982,999 for the 2017 period. The increase in tubular segment sales was driven by an increase in tons shipped from inventory and an increase in the average selling price per ton for these shipments. Tons sold increased from approximately 24,500 tons in the 2017 period to approximately 70,000 tons in the 2018 period. The average per ton selling price related to these shipments increased from approximately \$616 per ton in the 2017 period to approximately \$704 per ton in the 2018 period. Tubular segment operations recorded operating profits of approximately \$4,348,000 and \$261,000 in the 2018 and 2017 periods, respectively.

Management believes the improved tubular results are primarily related to the sustained recovery of the U.S. energy industry and the segment's new product offering of API line pipe. Late in the third quarter of fiscal 2018, TTP began actively producing, marketing and selling line pipe directly to distributors. Shipments of line pipe during the 2018 period totaled approximately 20,500 tons compared to approximately 2,000 tons in the 2017 period, accounting for approximately 41% of the 45,500 ton increase in total tubular sales volume. Management expects line pipe sales to be a significant component of total tubular segment sales moving forward.

Shipments of mill reject pipe during the 2018 period totaled approximately 38,000 tons compared to approximately 11,500 tons during the 2017 period, accounting for approximately 58% of the 45,500 ton increase in tubular sales volume. The increased shipping volume of mill reject pipe is due to improved demand and a concentrated effort to reduce the level of inventory.

Due to fluctuations in our customers' needs, revenue related to the finishing of customer owned pipe decreased \$827,256 in the 2018 period compared to the 2017 period.

USS has been the primary supplier of new mill reject pipe to the Company. In March 2016, USS announced it was temporarily idling pipe production at its Lone Star Tubular Operations facility due to weak market conditions. In December 2016, USS announced plans to permanently idle its #1 pipe mill at the Lone Star facility. In May 2017, USS resumed production at its Lone Star facility's #2 pipe mill. In February 2019, USS announced plans to restart its Lone Star facility's #1 pipe mill early in their third quarter of 2019. The Company expects the volume and size range of new mill reject pipe supply from USS to be reduced while the Lone Star facility's #1 pipe mill remains idle. USS is also a significant customer of the tubular segment's pipe-finishing facility. Loss of USS as a supplier or customer could have a material adverse effect on the Company's business. In general, the tubular segment purchases its inventory from a limited number of suppliers. Loss of any of these suppliers could have a material adverse effect on the Company's business.

### ***General, Selling and Administrative Costs***

During the 2018 period, general, selling and administrative costs increased \$874,140 compared to the 2017 period. This increase was related primarily to increases in bonuses and commissions associated with the increased earnings and sales volume.

### ***Income Taxes***

Income taxes in the 2018 period increased \$1,133,567 from the amount recorded in the 2017 period. This increase was related primarily to the increase in earnings before taxes for the 2018 period compared to the 2017 period but partially offset due to effects of the Tax Cuts and Jobs Act (the "Tax Act") that was enacted by the U.S. government on December 22, 2017. The Tax Act reduced the federal corporate tax rate applicable to the Company from 34% to 21% effective January 1, 2018.

### **Three Months Ended December 31, 2018 Compared to Three Months Ended December 31, 2017**

During the three months ended December 31, 2018 (the “2018 quarter”), sales, costs of goods sold and gross profit increased \$15,292,559, \$15,086,609 and \$205,950, respectively, compared to the amounts recorded during the three months ended December 31, 2017 (the “2017 quarter”). The increase in sales was related to both an increase in tons sold and an increase in the average per ton selling price. Tons sold increased approximately 23% from approximately 42,000 tons in the 2017 quarter to approximately 51,500 tons in the 2018 quarter. Discussion of the sales improvement is expanded upon at the segment level in the following paragraphs. Gross profit as a percentage of sales decreased from approximately 6.2% in the 2017 quarter to approximately 4.5% in the 2018 quarter.

### *Coil Segment*

Coil product segment sales for the 2018 quarter totaled \$28,730,992 compared to \$22,409,571 for the 2017 quarter, representing a sales increase of \$6,321,421 or approximately 28%. For a more complete understanding of the average selling prices of goods sold, it is helpful to isolate sales generated from processing of customer owned material and sales generated from coil segment inventory. Sales generated from processing of customer owned material totaled \$305,289 for the 2018 quarter compared to \$356,643 for the 2017 quarter. Sales generated from coil segment inventory totaled \$28,425,703 for the 2018 quarter compared to \$22,052,928 for the 2017 quarter. The increase in coil segment sales was driven by an increase in the average selling price per ton of material from inventory partially offset by a decrease in the volume of these shipments. The average per ton selling price related to these shipments increased from approximately \$658 per ton in the 2017 quarter to approximately \$905 per ton in the 2018 quarter. Inventory tons sold decreased from approximately 33,500 tons in the 2017 quarter to approximately 31,500 tons in the 2018 quarter. Coil segment operations recorded operating profits of approximately \$744,000 and \$1,233,000 in the 2018 and 2017 quarters, respectively.

The average selling price for the 2018 quarter was significantly higher than the 2017 quarter due to increased hot-rolled steel prices primarily associated with initial speculation and reaction to the U.S. government’s Section 232 steel trade actions and general steel industry and U.S. economic conditions. The price of hot-rolled steel increased steadily and significantly from the 2017 quarter and leading up to October 2018, the start of the 2018 quarter. During the 2018 quarter, hot-rolled steel prices decreased significantly and continued to decline into the Company’s fourth quarter. Management believes the decline in steel prices during the 2018 quarter was primarily associated with market participants managing inventory levels, temporary softness in the U.S. energy industry and uncertainty surrounding the volume and impact of foreign steel products at the start of 2019. As a result of the declining steel prices, the coil product segment experienced downward price pressure from its customers during the 2018 quarter. This downward price pressure combined with higher cost inventory making its way through cost of goods sold resulted in coil product segment margins contracting compared to the second quarter. Management expects further margin pressure in the fourth quarter due to steel prices continuing to decline during the first half of the fourth quarter. Around the start of February 2019, most domestic steel producers announced price increases for their products. Management believes the coil product segment’s margin compression will reverse if these price increases gain traction but the increases will take time to make their way through the supply chain to the consumers of the Company’s products. Management expects fourth quarter sales volume for the coil product segment to slightly exceed the third quarter volume.



The Company's coil segment purchases its inventory from a limited number of suppliers. Loss of any of these suppliers could have a material adverse effect on the Company's business.

*Tubular Segment*

Tubular product segment sales for the 2018 quarter totaled \$14,595,088 compared to \$5,623,950 for the 2017 quarter, representing a sales increase of \$8,971,138 or approximately 160%. For a more complete understanding of the average selling prices of goods sold, it is helpful to isolate sales generated from the finishing of customer owned pipe and sales generated from tubular segment inventory. Sales generated from finishing of customer owned pipe totaled \$66,734 for the 2018 quarter. There was no revenue generated from finishing of customer owned pipe during the 2017 quarter. Sales generated from tubular segment inventory totaled \$14,528,354 for the 2018 quarter compared to \$5,623,950 for the 2017 quarter. The increase in tubular segment sales was driven by an increase in tons shipped from inventory and an increase in the average selling price per ton for these shipments. Tons sold increased from approximately 8,500 tons in the 2017 quarter to approximately 20,000 tons in the 2018 quarter. The average per ton selling price related to these shipments increased from approximately \$648 per ton in the 2017 quarter to approximately \$723 per ton in the 2018 quarter. Tubular segment operations recorded an operating profit of approximately \$650,000 in the 2018 quarter and an operating loss of approximately \$53,000 in the 2017 quarter.

Management believes the improved tubular results are primarily related to the sustained recovery of the U.S. energy industry and the segment's new product offering of API line pipe. Late in the third quarter of fiscal 2018, TTP began actively producing, marketing and selling line pipe directly to distributors. Shipments of line pipe during the 2018 quarter totaled approximately 6,500 tons compared to approximately 2,000 tons in the 2017 quarter, accounting for approximately 39% of the 11,500 ton increase in total tubular sales volume. Management expects line pipe sales to be a significant component of total tubular segment sales moving forward.

Shipments of mill reject pipe during the 2018 quarter totaled approximately 10,500 tons compared to 4,000 tons during the 2017 quarter, accounting for approximately 57% of the 11,500 ton increase in total tubular sales volume. The increased shipping volume of mill reject pipe is due to improved demand and a concentrated effort to reduce the level of inventory.

Revenue related to the finishing of customer owned pipe was \$66,734 for the 2018 quarter. No revenue was generated from the finishing of customer owned pipe during the 2017 quarter. For the fourth quarter, management expects a low level of activity similar to that of the third quarter. These revenues are generated at the Company's pipe finishing facility that commenced operations in May 2017. The facility is designed to function optimally as a high volume processing facility with a small customer base. Operations at the facility have been sporadic as new customer relationships evolve and due to some fluctuation in the energy industry and the steel industry in general. In addition to cultivating existing customer relationships, management continues to seek additional customers that are a strategic fit for the facility. Management will continue to evaluate the long-term operating potential of the facility on a continual basis.

Compared to the second quarter, the tubular segment also experienced margin compression during the third quarter related to the decline in hot-rolled steel prices and higher cost inventory making its way through cost of goods sold. Management expects continued margin compression into the fourth quarter associated with these factors and additional pressure on selling prices due to an increased presence of foreign material associated with Section 232 quotas resetting at the start of 2019.

USS has been the primary supplier of new mill reject pipe to the Company. In March 2016, USS announced it was temporarily idling pipe production at its Lone Star Tubular Operations facility due to weak market conditions. In December 2016, USS announced plans to permanently idle its #1 pipe mill at the Lone Star facility. In May 2017, USS resumed production at its Lone Star facility's #2 pipe mill. In February 2019, USS announced plans to restart its Lone Star facility's #1 pipe mill early in their third quarter of 2019. The Company expects the volume and size range of new mill reject pipe supply from USS to be reduced while the Lone Star facility's #1 pipe mill remains idle. USS is also a significant customer of the tubular segment's pipe-finishing facility. Loss of USS as a supplier or customer could have a material adverse effect on the Company's business. In general, the tubular segment purchases its inventory from a limited number of suppliers. Loss of any of these suppliers could have a material adverse effect on the Company's business.

### *Income Taxes*

Income taxes in the 2018 quarter decreased \$343,873 from the amount recorded in the 2017 quarter. This decrease was related primarily to the 2017 quarter containing the impact from re-measuring deferred tax assets and liabilities pursuant to the Tax Act enacted during the 2017 quarter. The decrease is also associated with the Tax Act reducing the federal corporate tax rate applicable to the Company from 34% to 21% effective January 1, 2018. These circumstances contributing to decreased income taxes were partially offset by the increase in earnings before tax for the 2018 quarter.

### **FINANCIAL POSITION, LIQUIDITY AND CAPITAL RESOURCES**

We believe the Company remained in a strong, liquid position at December 31, 2018. The ratio of current assets to current liabilities was 4.5 and 6.1 at December 31, 2018 and March 31, 2018, respectively. Working capital was \$62,024,110 at December 31, 2018 and \$56,238,771 at March 31, 2018.

At December 31, 2018, the Company maintained assets and liabilities at levels it believed were commensurate with operations. Changes in balance sheet amounts occurred in the ordinary course of business. Cash decreased primarily as a result of the purchase of inventory, the purchase of property, plant and equipment and the payment of cash dividends partially offset by net earnings and an increase in accounts payable. The balance of accounts payable and inventory rose considerably due to the volume and timing of inventory purchases for both the Company's coil and tubular segments. The Company expects to continue to monitor, evaluate and manage balance sheet components depending on changes in market conditions and the Company's operations.

In December 2018, the Company's \$7,500,000 revolving line of credit facility expired and the Company put into place a new \$5,000,000 revolving line of credit facility (the "Credit Facility") that expires December 12, 2019. Access to funds under the Credit Facility is subject to a borrowing base requirement. The borrowing base is calculated as 80% of eligible tubular segment accounts receivable plus 40% of eligible tubular segment inventory. The total amount contributed to the borrowing base by eligible inventory shall not exceed \$3,000,000. At December 31, 2018 and as of the filing date of this quarterly report on Form 10-Q, the borrowing base calculations would allow the Company access to the full \$5,000,000 available under the Credit Facility. At December 31, 2018 and as of the filing date of this quarterly report on Form 10-Q, the Company had no borrowings outstanding under the Credit Facility. The Company was not in violation of any terms or covenants related to the Credit Facility as of the filing date of this quarterly report on Form 10-Q.

The Company believes that its current cash position along with operating cash flow potential and borrowing capability due to its financial position are adequate to fund its expected cash requirements for the next 24 months.

## **CRITICAL ACCOUNTING POLICIES**

The preparation of consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Significant estimates that are subject to the Company's assumptions include the determination of useful lives for fixed assets and the determination of the allowance for doubtful accounts. The determination of useful lives for depreciation of fixed assets requires the Company to make assumptions regarding the future productivity of the Company's fixed assets. The allowance for doubtful accounts requires the Company to draw conclusions on the future collectability of the Company's accounts receivable. Actual results could differ from these estimates.

## **CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

From time to time, the Company may make certain statements that contain forward-looking information (as defined in the Private Securities Litigation Reform Act of 1996, as amended) and that involve risk and uncertainty. Such statements may include those risks disclosed in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this report. These forward-looking statements may include, but are not limited to, future changes in the Company's financial condition or results of operations, future production capacity, product quality and proposed expansion plans. Forward-looking statements may be made by management orally or in writing including, but not limited to, this Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of the Company's filings with the U.S. Securities and Exchange Commission (the "SEC") under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including the Company's Annual Report on Form 10-K and its other Quarterly Reports on Form 10-Q. Forward-looking statements include those preceded by, followed by or including the words "will," "expect," "intended," "anticipated," "believe," "project," "forecast," "propose," "plan," "estimate," "enable," and similar expressions, including, for statements about our business strategy, our industry, our future profitability, growth in the industry sectors we serve, our expectations, beliefs, plans, strategies, objectives, prospects and assumptions, and estimates and projections of future activity and trends in the oil and natural gas industry. These forward-looking statements are not guarantees of future performance. These statements are based on management's expectations that involve a number of business risks and uncertainties, any of which could cause actual results to differ materially from those expressed in or implied by the forward-looking statements. Although forward-looking statements reflect our current beliefs, reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. Actual results and trends in the future may differ materially depending on a variety of factors including, but not limited to, changes in the demand for and prices of the Company's products, changes in the demand for steel and steel products in general and

the Company's success in executing its internal operating plans, including any proposed expansion plans. Accordingly, undue reliance should not be placed on our forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events, changed circumstances or otherwise, except to the extent law requires.

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

Not required

### **Item 4. Controls and Procedures**

The Company's management, with the participation of the Company's principal executive officer ("CEO") and principal financial officer, evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act), as of the end of the fiscal quarter ended December 31, 2018. Based on this evaluation, the Company's CEO and principal financial officer have concluded that the Company's disclosure controls and procedures were effective as of the end of the fiscal quarter ended December 31, 2018 to ensure that information that is required to be disclosed by the Company in the reports it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to the Company's management, including the CEO and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

There were no changes in the Company's internal control over financial reporting that occurred during the fiscal quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**FRIEDMAN INDUSTRIES, INCORPORATED**

**Three Months Ended December 31, 2018**

**Part II — OTHER INFORMATION**

**Item 6. Exhibits**

Exhibits

- 3.1 Articles of Incorporation of the Company, as amended (incorporated by reference from Exhibit 3.1 to the Company's Form S-8 filed on December 21, 2016).
- 3.2 Articles of Amendment to the Articles of Incorporation of the Company, as filed with the Texas Secretary of State on September 22, 1987 (incorporated by reference from Exhibit 3.1 to the Company's Form S-8 filed on December 21, 2016).
- 3.3 Amended and Restated Bylaws of the Company (incorporated by reference from Exhibit 3.2 to the Company's Form S-8 filed on December 21, 2016).
- 10.1 Revolving Line of Credit Loan Agreement, dated December 12, 2018 (incorporated by reference from Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the SEC on December 18, 2018).
- 10.2 Promissory Note, dated December 12, 2018 (incorporated by reference from Exhibit 10.2 to the Company's Current Report on Form 8-K, filed with the SEC on December 18, 2018).
- 10.3 Commercial Security Agreement, dated December 12, 2018 (incorporated by reference from Exhibit 10.3 to the Company's Current Report on Form 8-K, filed with the SEC on December 18, 2018).
- 31.1 ~~Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, signed by Robert Sparkman~~
- 31.2 ~~Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, signed by Alex LaRue~~
- 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, signed by Robert Sparkman
- 32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, signed by Alex LaRue

101.INS -XBRL Instance Document

101.SCH ~~XBRL~~ Taxonomy Schema Document

101.CAL ~~XBRL~~ Calculation Linkbase Document

101.DEF ~~XBRL~~ Definition Linkbase Document

101.LAB ~~XBRL~~ Label Linkbase Document

101.PRE ~~XBRL~~ Presentation Linkbase Document

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**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.

FRIEDMAN INDUSTRIES,

INCORPORATED

Date: February 14, 2019

By/s/ ALEX LARUE

Alex LaRue, Chief Financial Officer –

Secretary and Treasurer

(Principal Financial Officer)