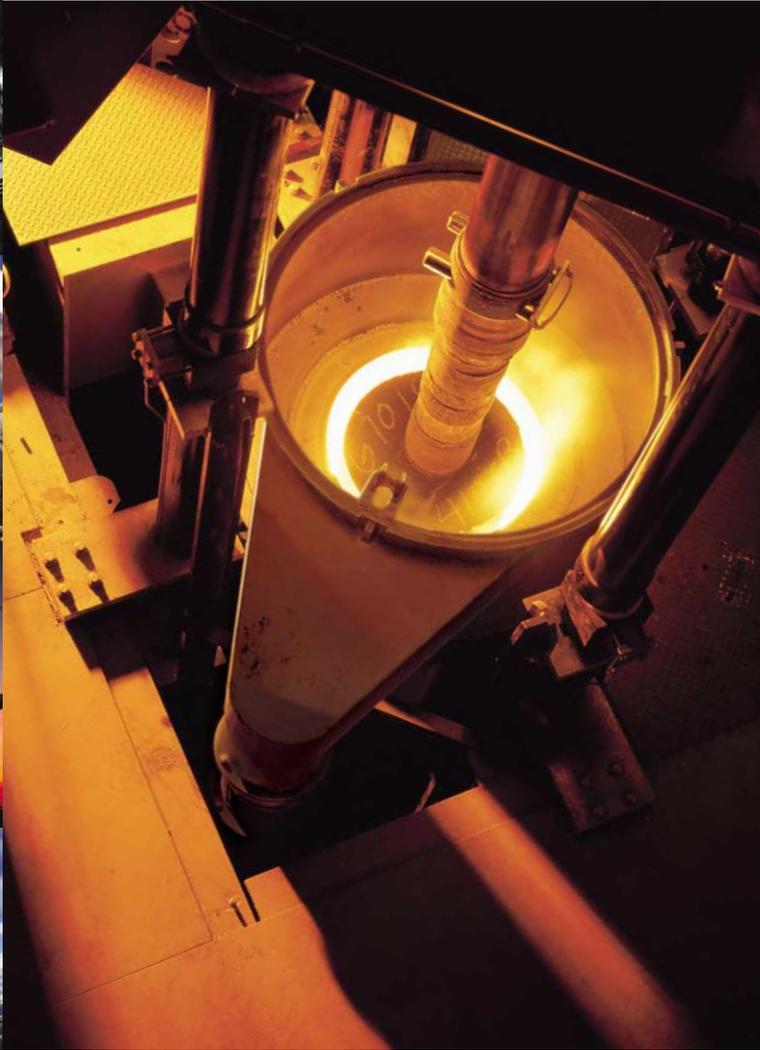
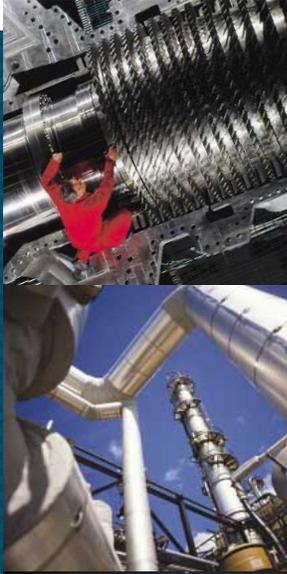


2001

ANNUAL REPORT



Universal Stainless & Alloy Products, Inc.



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Letter to Our Stockholders

In a year marked by industry, economic and national challenges, Universal Stainless & Alloy Products achieved record sales and earnings, substantially outperforming our peers and even our own projections. Why?

OUR NICHE MARKET STRATEGY. We focused on the right markets and the right niches within them. Power generation and aerospace saw especially robust performance. We not only increased sales to existing customers, but also added new ones.

BY LISTENING TO OUR CUSTOMERS. We made the right investments by responding to changing customer needs and market opportunities with the highest quality products and the greatest level of dependability.

THE COMMITMENT OF OUR EMPLOYEES. We challenged our employees, who share directly in our profits, to help reduce our costs. The manufacturing process for specialty steels requires advanced technical expertise and exacting production methods. We see the dedication and commitment of our employees as not simply an ideal, but an everyday necessity.

These factors combined to make 2001 an outstanding year for Universal Stainless. Net income increased by 51%, reaching \$7.6 million or \$1.25 per diluted share, up from \$5.1 million or \$0.83 per diluted share in 2000. Net sales on shipments increased by 20% to \$90.7 million, up from \$75.9 million in 2000. Earnings before interest, taxes, depreciation and amortization totaled \$15.4 million or \$2.53 per share. Each of these increases set new records for the Company. Universal Stainless ended 2001 with one of the strongest balance



Clarence M. McAninch President and Chief Executive Officer (center)
Paul A. McGrath Vice President of Operations, General Counsel & Secretary (left)
Richard M. Ubinger Vice President of Finance, Chief Financial Officer and Treasurer (right)

sheets in our industry. Our debt-to-total capitalization ratio was just 13%, and our book value reached \$9.28 per share.

In last year's message, I outlined a number of areas we would emphasize in 2001. Let's quickly review the progress made in those areas:

IDENTIFYING NEW MARKET NICHES AND ADDITIONAL COST-REDUCTION OPPORTUNITIES. We achieved 10% growth in the number of customers we served in 2001, and this growth occurred across the board. No single market segment dominated our growth pattern.

This reflects positively on Universal Stainless' balanced revenue stream and on our ability to generate customer satisfaction and loyalty in all of the market segments that we pursue.

We have seen substantial growth in our bar mill products, as a result of gaining customer acceptance and capturing new market niches. In addition, the profitability of bar mill products increased by \$1.9 million in 2001 compared with the prior year.

REDUCED PRODUCTION CYCLE TIMES AND ENHANCED COST-EFFICIENCY TO MEET THE GROWING DEMAND.

Our new ingot grinder and billet grinder – both installed to enhance our in-house capabilities, reduce costs and improve quality – have resulted in higher customer satisfaction. We have installed improved environmental controls, including an upgraded hazardous waste system that contributes to greater efficiency of operations. We also installed a new electro-slag remelt furnace, now operating to meet customer demand for ultra-clean steels. This unit, our fourth ESR furnace, came online flawlessly – so much so, that we were able to ship to a customer the first ingot processed in January 2002. That's virtually unheard of in the steel industry.

IMPROVED ON-TIME DELIVERY AND REDUCED INVENTORY LEVELS. We have reduced our inventory in relation to our backlog as a result of implementing the i2 Technologies RHYTHM Factory Planner inventory tracking software. This system enables us to quote customers more accurate lead-times, to schedule material through the melt shop and the rest of the facility more effectively, and to track output in a more timely fashion. This process reduces our overall inventory and ultimately the cost to carry that inventory. While our on-time delivery performance improved after the software was installed, we anticipate further improvements in 2002.

As we enter 2002, we are seeing the continuation of the difficult economy. Power consumption has declined and natural gas costs have decreased with the idling of manufacturing facilities, impacting demand for power generation and petrochemical products. The commercial aerospace industry has reduced its production plans as a result of the September 11 tragedy. When economic conditions improve, we will capitalize on the accomplishments of the past year and these anticipated opportunities:

CERTAIN MARKETS ARE POISED FOR CONTINUED GROWTH. Several of our forging and OEM customers serving the power generation and petrochemical industries have informed us that demand for their products will improve with the economy during 2002. The addition of our fourth ESR furnace will enable us to respond to an increase in demand promptly.

Similarly, several market indicators point to the demand in the aerospace market improving in spite of the commercial aviation slowdown experienced after the September 11 tragedy. These indicators include proposed higher defense spending at the federal level and placement of orders for jet fighter aircraft and for refueling aircraft to replace the aged KC 135 tankers. Lower inventory levels among service centers supplying the aerospace market represent another positive sign for us.

OUR INDUSTRY REMAINS RIPE FOR CONSOLIDATION. Universal Stainless will continue to look for acquisition opportunities to add to our product line, offer cost-efficiencies and enhance profitability.

In line with this strategy, we recently announced the acquisition of the assets of Empire Specialty Steel, Inc., located in Dunkirk, New York. The addition of finished specialty steel rod and wire products and the expanded line of bar products will enable Universal Stainless to broaden our product offerings to existing customers within our markets and to enter new niches. It will also permit us to more fully utilize the production capacity of our Bridgeville and Titusville facilities to create additional higher value products. Building on our reputation for producing the highest quality products, we now will be able to offer the marketplace a desirable alternative to imports in a broad range of finished product categories.

Without question, 2001 has been a unique year, yet we have achieved record sales and net income results based on adherence to our proven strategy. Our business model, which has been in place since we began operations more than seven years ago, is built on serving niche markets

with dedicated employees and on developing deep, long-term customer relationships, some of which we highlight in the following pages.

Customer relationships remain the lifeblood of our success. We work hard to provide a quality product and deliver it on a timely basis. Our customers know we want to improve their bottom-line profitability to ensure our bottom-line profitability. This is our distinguishing factor – proving every day to our customers that Universal Stainless is the best possible supplier they can find in the marketplace.

On behalf of our board of directors and our employees, thank you for your ongoing belief in Universal Stainless. We will keep you informed on our performance throughout the coming year.



Clarence M. “Mac” McAninch
President and Chief Executive Officer
Universal Stainless & Alloy Products, Inc.

“We outperformed our industry and our own expectations in 2001 through the disciplined execution of our business strategy. It is the same strategy that we will pursue in 2002 and beyond.”

Clarence M. “Mac” McAninch
President and Chief Executive Officer

Universal Stainless & Alloy Products Strategy

Universal Stainless & Alloy Products has succeeded in a traditionally difficult industry because it remains steadfast in its pursuit of three key strategies:

- >> Reinvest profits to enhance customer service and reduce costs.
- >> Maintain a niche market focus.
- >> Remember that the customer is number one and that our employees are critical to our success.

Since we began operations, we have stressed that only through the dedication of our people can Universal Stainless outperform the industry and achieve profitable growth. That is why the Company makes the special effort to make sure employees share in our success.

The remaining elements of Universal Stainless' three-part strategy deal with relationships between the Company and its customers. The stories that follow highlight specific instances illustrating the ideals that have kept Universal Stainless on the path to profitable growth.



Reinvest Profits

When your name's on the company letterhead, you make sure everything is top notch – including the material received from your suppliers. Ron Cincinnati of the Cincinnati Tool Steel Company of Rockford, Illinois, can vouch for that.

His company purchases hot rolled and annealed plate from Universal Stainless, which is then ground from top and bottom and cut into bar stock for sale to its customers. Ron praises Universal Stainless for its high standard of business ethics, loyalty to its customers, consistent service and cost competitiveness. But he saves his highest praise for the unquestioned quality of the steel he receives from Universal Stainless.

Plate product received from Universal Stainless must be flat to ensure that the product cleans up and reduces machining time. Universal Stainless understands the critical nature of this particular customer's specifications and, according to Ron, the product received is always excellent. Consistent reinvestment in Universal Stainless' engineering and production capabilities gets the credit.

"The steel needs to be flatter than their competitors' steel," Ron said. "Universal Stainless stands behind its product and has served us well. We're dealing with the best when we deal with Universal Stainless. But they understand that being competitive, supplying a quality product and meeting delivery requirements is what gets my business."



"The steel needs to be flatter than their competitors' steel," Ron said. "Universal Stainless stands behind its product and has served us well. We're dealing with the best when we deal with Universal Stainless."

Ron Cincinnati
President and Owner
Cincinnati Tool Steel Company

Enhance Customer Service

Just as a chain is only as strong as its weakest link, a company like Pratt & Whitney-Canada knows that each individual component that goes into its aircraft engines must be flawless. High quality standards are only the cost of admission – it's all but assumed that suppliers have superior products, otherwise they wouldn't even be included in the mix.

That, in turn, makes attributes such as accountability and responsibility all the more important in keeping relationships alive and flourishing. That's why Pratt & Whitney-Canada values its relationship with Universal Stainless.

Universal Stainless produces premium rolled steel at its Titusville plant for Pratt & Whitney-Canada. The steel is cut into size by Pratt & Whitney-Canada and used in compressor mains inside aircraft engines. End-users of these engines include Cessna, Raytheon, Piper and Air Tractor, among others.

During a particular production run in 2001, the shape began to deviate from the required specifications. Universal Stainless stopped the run, corrected the problem and had material in production again. It also notified Pratt & Whitney-Canada that a problem had existed. This kind of up-front, honest, ethical behavior has earned Universal Stainless the respect and continued business of Pratt & Whitney-Canada.





Reduce Costs

Reliability means a lot when you promise a quicker turnaround than your competitors. T&W Forge, based in Alliance, Ohio, has promoted shorter lead times as a primary competitive advantage. That makes imperative the time-sensitivity of its partners, as well.

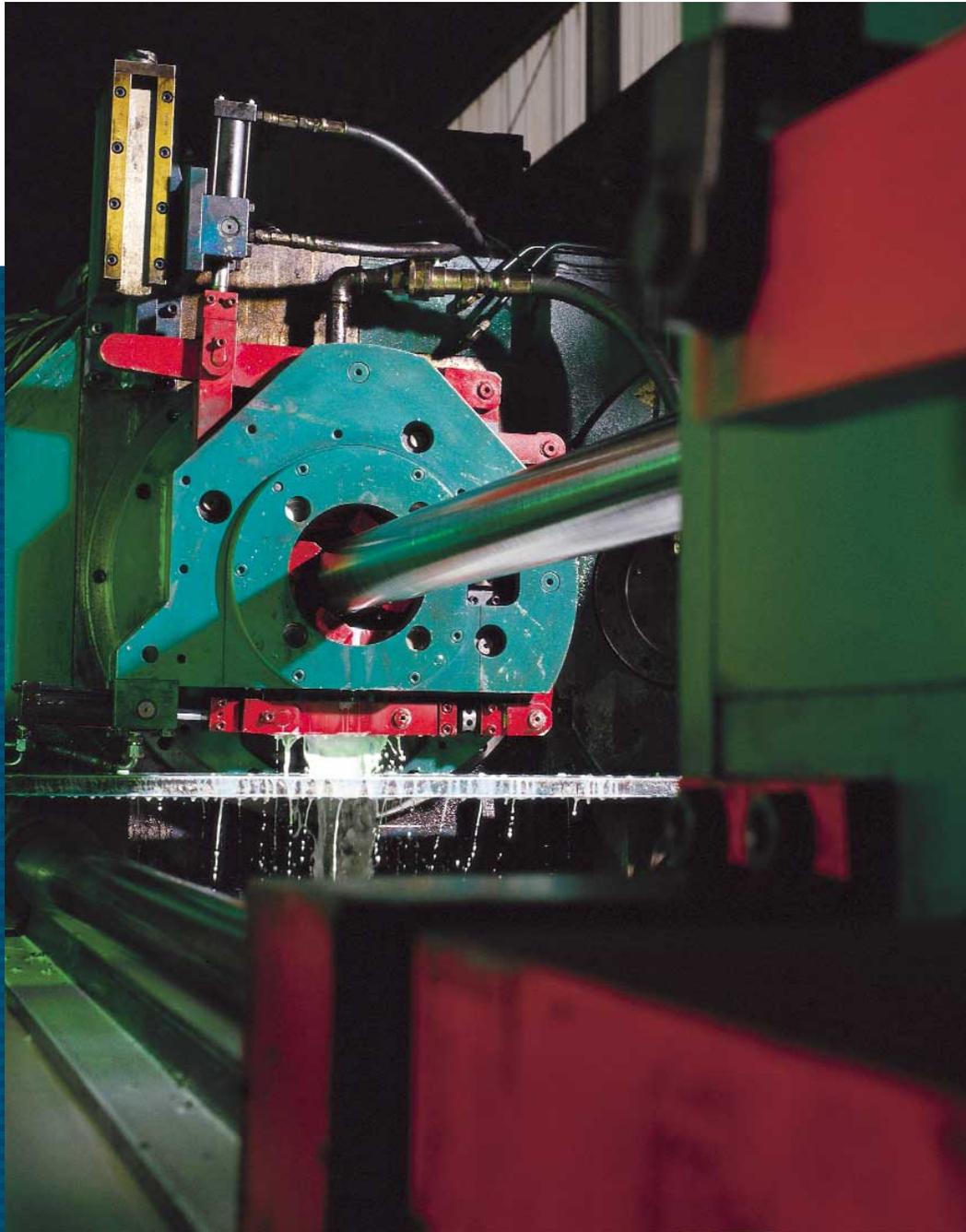
After purchasing bars from Universal Stainless, T&W Forge cuts, heats and forges them for ultimate use within the power generation industry. Universal Stainless is one of a few mills certified to meet this industry's stringent specifications.

“Business as usual with Universal Stainless is really business as unusual,” explained Larry Stalnaker, president of T&W Forge. “Our lead times are about 50% shorter than our competition. Universal Stainless keeps billets on hand for us, so that they can get rolled and shipped quickly. Because they're certified, we don't have to go shopping around.

“They're dependable – we've never missed a shipment to one of our customers due to a delay in receiving a shipment from Universal Stainless,” Larry said. “Cost isn't always the price you pay up front. It's how much cost you have in the delivered goods. We're pretty happy with the costs from Universal Stainless. That's because when we make our promises to customers, we know Universal Stainless will back us up.”

“When we make our promises to customers, we know Universal Stainless will back us up.”

Larry Stalnaker
President
T&W Forge



“There are items Universal Stainless can make that others can’t. That means as they grow, our business with them will grow accordingly. If Universal Stainless makes it, we’ll buy it.”

Steve Fry
Chairman, President and Chief Executive Officer
Fry Steel Company

Remember the Customer is Number One

When a client has a quality-related issue, Universal Stainless offers not only its operating professionals to assist in solving it, but also its technical staff. The goal is to help the client succeed in serving its customer so that it continues to get new orders. Universal Stainless operates on the philosophy that by making the customer number one – by helping its customers win – it will continue to win as well.

For example, in the case of Talley Metals Technology Inc., its long-term relationship with Universal Stainless continued after Talley was acquired by Carpenter Technology Corp. in 1998. The following year, Talley and Universal Stainless implemented a supply agreement that remains in place today. Talley expects – and receives – a quality product that adheres to rigid specifications and that is delivered on time.

According to Talley, “Universal Stainless is flexible and will do what is necessary to support Talley with new chemistry ranges or accelerated delivery schedules. The key to this business relationship is trust in each other’s commitment and capabilities.”





“Universal Stainless is flexible and will do what is necessary to support Talley with new chemistry ranges or accelerated delivery schedules. The key to this business relationship is trust in each other’s commitment and capabilities.”

Talley Metals

Facilities

Bridgeville

Titusville

Dunkirk

MELTING AND REFINING

50-ton electric arc furnace
50-ton AOD vessel
Ladle treatment facility with wire feed
100% bottom pour ingot casting
4 electro-slag remelt furnaces
5 vacuum-arc remelt furnaces

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■
■

■

ROLLING

High-lift universal rolling mill
5 hot rolling bar mills
Rod and bar mill
Precision cold rolling mills

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FINISHING

Round bar finishing facility
Flat bar finishing facility
Wire finishing facility
Plate flattening and saw cutting
4 milling and grinding machines
Heat treating and annealing facilities

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Products

INGOT

As required

■

REROLL OR FORGING BILLET

2" – 14" RCS

■

FORGED ROUNDS

6" – 15" diameter

■

SLAB

6" – 12" thick • 26" – 52" wide

■

PLATE

0.5" – 6" thick • 26" – 42" wide

■

BAR

Round

0.187" – 6"

■

Hexagon

0.187" – 1.875"

Square

0.187" – 3"

Flat

0.250" – 9" thick • 0.625" – 18" wide

■

REBAR

Sizes #3 to #11

ROD

0.217" – 0.843"

WIRE

0.040" – 0.750"

SPECIAL SHAPES

0.035" – 0.375" thick • 2" – 9" wide

■

Conversion melting, remelting and rolling are available.

Contact Information

Toll-Free

Phone

Fax

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121 Caldwell Street, Titusville, PA 16354

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800.743.5970

412.257.7600
814.827.9723

412.257.7640
814.827.2766

DUNKIRK SPECIALTY STEEL, LLC

88 Howard Avenue, Dunkirk, NY 14048

800.916.9133

716.366.1000

716.366.0478

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

During 2000, the Company adopted the provisions of the Securities and Exchange Commission's ("SEC") Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements." The application of the SEC's guidance to the language contained in the Company's Standard Terms and Conditions of Sale existing at the time of adoption required the Company to defer revenue until cash was collected, even though risk of loss passed to the buyer at the time of shipment. This had the effect of deferring certain sale transactions previously recognized in 1999 into 2000. During the fourth quarter of 2000, the Company modified its Standard Terms and Conditions of Sale to more closely reflect the substance of its sale transactions, which resulted in revenue being recorded at the time of shipment rather than when cash was received. As a result, revenue and cost information in 2000 include amounts related to shipments made during the year as well as amounts deferred from 1999. In order to facilitate analysis of the Company's results of operations, amounts in the tables below summarize revenue and cost information based on shipments made by the Company in the respective years. Such amounts are then reconciled to reported amounts as necessary.

An analysis of the Company's operations is as follows:

	2001		2000		1999	
	Amount	%	Amount	%	Amount	%
<i>(dollars in thousands)</i>						
NET SALES						
Stainless steel	\$ 76,908	84.8%	\$ 62,346	70.6%	\$ 55,255	82.9%
Tool steel	4,503	5.0	6,960	7.9	6,055	9.1
High-strength low alloy steel	3,379	3.7	2,161	2.4	1,327	2.0
High-temperature alloy steel	2,471	2.7	1,754	2.0	2,124	3.2
Conversion services	3,054	3.4	2,309	2.6	1,807	2.7
Other	343	0.4	355	0.4	95	0.1
Net sales on shipments	90,658	100.0	75,885	85.9	66,663	100.0
Effect of accounting change	-	-	12,462	14.1	-	-
Total net sales	90,658	100.0	88,347	100.0	66,663	100.0
COST OF PRODUCTS SOLD						
Raw materials	25,791	28.5	26,290	29.7	24,732	37.1
Other	46,124	50.9	35,583	40.3	33,901	50.9
Total cost of products shipped	71,915	79.4	61,873	70.0	58,633	88.0
Effect of accounting change	-	-	9,988	11.3	-	-
Total cost of products sold	71,915	79.4	71,861	81.3	58,633	88.0
Selling and administrative expenses	6,199	6.8	4,998	5.7	4,299	6.4
Operating income from shipments	12,544	13.8	9,014	10.2	3,731	5.6
Effect of accounting change	-	-	2,474	2.8	-	-
Operating income	\$ 12,544	13.8%	\$ 11,488	13.0%	\$ 3,731	5.6%

Net sales on shipments by market segment are as follows:

	2001		2000		1999	
	Amount	%	Amount	%	Amount	%
<i>(dollars in thousands)</i>						
Rerollers	\$ 31,936	35.2%	\$ 33,549	44.2%	\$ 36,522	54.8%
Service centers	19,178	21.2	16,137	21.3	11,130	16.7
Forgers	18,484	20.4	14,288	18.8	9,185	13.8
Original equipment manufacturers	17,714	19.5	9,321	12.3	7,761	11.6
Conversion services	3,054	3.4	2,309	3.0	1,807	2.7
Miscellaneous	292	0.3	281	0.4	258	0.4
Total	\$ 90,658	100.0%	\$ 75,885	100.0%	\$ 66,663	100.0%

2001 RESULTS AS COMPARED TO 2000 The increase in net sales on shipments in 2001 reflects increased shipments within each market segment, except Reroller, partially offset by price decreases related to lower raw material costs. The Company shipped approximately 46,800 tons in 2001, compared to shipments of 41,800 tons in 2000. The increased sales were primarily due to increased shipments of power generation, aerospace and petrochemical products to the Company's reroller, forging, service center and OEM markets. These increases were partially offset by lower sales of commodity products to the reroller market and of tool steel products to the service center market, primarily due to imports and the recessionary economy experienced during 2001.

Cost of products sold, as a percent of net sales, decreased in 2001 as compared to 2000. This decrease was primarily due to the impact of the change in the mix of products shipped and the improved operating results at the bar mill. Natural gas costs increased by approximately \$1.3 million in 2001 in comparison to 2000 because of higher rates.

Selling and administrative expenses increased by \$1.2 million in 2001 as compared to 2000. This increase primarily reflects higher insurance and other costs associated with the revenue growth experienced during 2001. In addition, the Company recorded a \$200,000 charge to demolish certain vacant buildings within the Bridgeville facility, a \$190,000 obligation to its former Vice President of Operations and a \$115,000 charge for the services of an investment banking firm previously engaged to evaluate various strategic alternatives to increase shareholder value.

Interest expense and other financing costs decreased from \$905,000 in 2000 to \$576,000 in 2001 primarily due to the continued reduction of long-term debt outstanding and a reduction in interest rates on the PNC Term Loan.

The 2001 effective income tax rate was 36.5% compared to 37.5% in 2000. The decrease in the effective income tax rate is primarily attributable to the application of the Extraterritorial Income Exclusion provisions for federal tax purposes and state tax credits made available to the Company during 2001.

2000 RESULTS AS COMPARED TO 1999 The increase in net sales on shipments in 2000 reflects an improved sales mix of products and price increases to cover higher material and energy costs partially offset by lower shipment volumes. The Company shipped approximately 41,800 tons in 2000, compared to shipments of 44,800 tons in 1999. The improved sales mix was primarily due to increased shipments of power generation, aerospace and petrochemical products to the Company's reroller, forging and OEM market customers, and tool steel and bar mill products to the Company's service center customers. These increases were partially offset by the impact of lower sales of commodity products due to increased imports.

Cost of products sold, as a percent of net sales, decreased in 2000 as compared to 1999. This decrease was primarily due to the impact of the change in the mix of products shipped, improved operating results at the bar mill and higher sales prices.

Selling and administrative expenses increased by \$699,000 in 2000 as compared to 1999. This increase reflects higher employment and insurance costs.

Interest expense and other financing costs increased from \$736,000 in 1999 to \$905,000 in 2000 primarily due to a reduction in capitalized interest and higher interest rates on the PNC Term Loan.

The 2000 effective income tax rate was 37.5% compared to 30.5% in 1999. The increase in the effective income tax rate is primarily attributable to the reduced impact of the Company's permanent state tax deductions resulting from higher income levels in 2000.

Liquidity and Capital Resources

The Company generated cash flow from operations in 2001 and 2000 of \$11.9 million and \$6.3 million, respectively. This increase is primarily due to the increase in net income and the impact of changes in deferred taxes, partially offset by an increase in working capital.

At December 31, 2001, working capital approximated \$28.7 million, as compared to \$23.6 million at December 31, 2000. The ratio of current assets to current liabilities at December 31, 2001 and 2000, was 4.0:1 and 3.2:1, respectively. The debt to capitalization ratio was 13% at December 31, 2001 and 17% at December 31, 2000. The increase in working capital is primarily attributable to the increase in cash and cash equivalents generated from operations.

CAPITAL EXPENDITURES AND INVESTMENTS The Company's capital expenditures were approximately \$5.3 million and \$4.6 million in 2001 and 2000, respectively, which primarily reflect the installation of a new electro-slag remelt furnace and building improvements at the Bridgeville facility. Capital expenditures not associated with the acquisition described below are expected to approximate \$4.0 million in 2002 and will be used primarily to complete projects previously initiated and to upgrade or replace various pieces of equipment at the Bridgeville and Titusville facilities. These expenditures are expected to be funded substantially from internally generated funds and additional borrowings.

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

PNC CREDIT AGREEMENT On June 29, 2001 the Company entered into a third amendment to the second amended and restated credit agreement with PNC Bank which extended the term of the \$6.5 million revolving credit facility ("PNC Line") to April 30, 2003. This credit agreement also includes a term loan ("PNC Term Loan") scheduled to mature in June 2006 and is collateralized by substantially all of the Company's assets.

Interest on borrowings under the PNC Line and the PNC Term Loan is based on short-term market rates, which may be further adjusted based upon the Company maintaining certain financial ratios. As a condition of the PNC Line and the PNC Term Loan, the Company is required to maintain certain levels of net worth, working capital and other financial ratios; to limit the amount of capital expenditures it may incur without PNC Bank's approval; and to restrict the payment of dividends. As of December 31, 2001, the Company was in compliance with all financial ratios and restrictive covenants.

STOCK REPURCHASE PROGRAM On October 19, 1998, the Company initiated a stock repurchase program to repurchase up to 315,000 shares of its outstanding Common Stock in open market transactions at market prices. There were 12,000 shares of Common Stock repurchased by the Company during 2001. The Company is authorized to repurchase an additional 45,100 shares of Common Stock as of December 31, 2001.

SUPPLY CONTRACT The Company maintains a supply contract agreement with Talley Metals Technology, Inc., a subsidiary of Carpenter Technology Corporation, which is currently effective through December 2002. Under terms of the agreement, the Company will supply Talley Metals with an average of 1,250 tons of stainless reroll billet products per month. The value of the contract on a monthly basis will depend on product mix and key raw material prices.

ENVIRONMENTAL MATTERS The Company, as well as other steel companies, is subject to demanding environmental standards imposed by federal, state and local environmental laws and regulations. In connection with the 1994 acquisition of the Bridgeville facility assets from Armco, which merged with and into AK Steel in 1999 (“Armco”), Armco agreed to retain responsibility for liabilities asserted against it under environmental laws with respect to environmental conditions existing at the Bridgeville facility prior to commencement of the long-term net lease of that facility on August 15, 1994, and to indemnify the Company up to \$6.0 million in the aggregate over ten years. Such indemnification expires on August 15, 2004.

In connection with the Company’s June 2, 1995 agreement with Armco to purchase certain assets and a parcel of real property located at Titusville, Armco agreed to indemnify the Company up to \$3.0 million in the aggregate for liabilities under environmental laws arising out of conditions on or under the Titusville property existing prior to June 2, 1995. Armco’s obligation to indemnify the Company for any liabilities arising out of environmental conditions existing off-site as of June 2, 1995, is not subject to the \$3.0 million limitation.

Management is not aware of any financial difficulties being experienced by AK Steel, as successor to Armco, that would prevent its performance under the acquisition agreements. In addition, management is not aware of any environmental conditions or the incurrence of other liabilities at the Bridgeville or Titusville facilities, for which Armco has agreed to indemnify the Company, nor of any material environmental condition requiring remediation and affecting the Company.

CRITICAL ACCOUNTING POLICIES Revenue recognition is the most critical accounting policy of the Company. The Company manufactures specialty steel product in accordance with customer purchase orders that contain specific product requirements. Each purchase order provides detailed information regarding the requirements for product acceptance. Executed material certification forms are completed indicating the Company’s compliance with the customer purchase order before the specialty steel products are packaged and shipped to the customer. Revenue is generally recognized at point of shipment because risk of loss and title have transferred. During 2001, revenue was recognized in certain situations in which products available for shipment are held at the Company’s facility beyond the stated shipment date at the customer’s specific request.

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 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 collectable. An inventory reserve is provided for material on hand for which management believes cost exceeds fair market value and for certain material on hand not assigned to a specific customer order.

NEW ACCOUNTING PRONOUNCEMENTS Financial Accounting Standards Board (“FASB”) Statement No. 133, “Accounting for Derivative Instruments and Hedging Activities” was issued in June 1998, and amended in June 1999 and in June 2000, pursuant to FASB Statement No. 137, “Accounting for Derivative Instruments and Hedging Activities: Deferral of the Effective Date of FASB Statement No. 133” and FASB Statement No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities: an amendment of FASB No. 133,” respectively. These statements require that an entity recognize certain derivative instruments as either assets or liabilities in the statement of financial position and measure those instruments at fair value. The adoption of these statements on January 1, 2001, did not impact the Company’s results of operations or financial condition.

In July 2001, the FASB issued Statement No. 141, “Business Combinations” and Statement No. 142, “Goodwill and Other Intangible Assets.” In August 2001, the FASB issued Statement No. 143, “Accounting for Asset Retirement Obligations.” In October 2001, the FASB issued Statement No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” These statements will be adopted in 2002 and are not expected to impact the Company’s results of operations or financial condition.

SHORT- AND LONG-TERM LIQUIDITY The Company expects to meet substantially all of its short-term liquidity requirements with internally generated funds and borrowings under the PNC Credit Agreement. At December 31, 2001, the Company had \$5.5 million in cash and \$6.5 million available under the PNC Line.

The Company's long-term liquidity depends upon its ability to obtain additional orders from its customers, attract new customers and control costs during periods of low demand or pricing. At this time, management intends to closely monitor its discretionary spending until general economic conditions improve.

SECTION 201 On October 22, 2001, the U.S. International Trade Commission ("ITC") determined that imports of certain stainless steel and alloy tool steel products are seriously injuring the domestic specialty steel industry. This determination allows the President of the United States, under Section 201 of the 1974 Trade Act, to restrict imports or impose tariffs on some or all of the products at issue. On March 5, 2002, the President imposed tariffs on certain imported stainless steel rod, bar and wire products ranging from 6% to 15% over the next three years. At this time, the Company is unable to determine the potential impact of the imposed remedy on the Company's future results of operations and liquidity requirements.

SUBSEQUENT EVENT On February 14, 2002, the Company, through its wholly owned subsidiary, Dunkirk Specialty Steel, LLC ("Dunkirk Specialty Steel") acquired from the New York Job Development Authority ("JDA") certain assets formerly owned by Empire Specialty Steel, Inc. ("Empire") at its idled production facility located in Dunkirk, NY (the "Dunkirk facility"). The assets acquired include the inventory; property, plant and equipment; and selected intangible assets. The purchase price of \$4.0 million will be funded with \$1.0 million in cash, paid at closing, and ten-year, 5% interest bearing notes payable to the JDA in the amount of \$3.0 million. No principal or interest payments are payable during the first year. The Company will not assume any liabilities of Empire. Capital expenditures are expected to approximate \$6.0 million at the Dunkirk facility in 2002.

GENERAL Actual results will be affected by a wide range of factors including the start-up of the Dunkirk, New York production facility; the receipt, pricing and timing of future customer orders; changes in product mix; the concentrated nature of the Company's customer base to date and the Company's dependence on its significant customers; the Company's reliance on certain critical manufacturing equipment; the limited number of raw material and energy suppliers and significant fluctuations that may occur in raw material and energy prices; and the Company's ongoing requirement for continued compliance with environmental laws. 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. Many of these factors are not within the Company's control, and there can be no assurances regarding the Company's future sales or earnings. For a discussion of these and other matters, refer to the Company's Annual Report on Form-10K for the year ended December 31, 2001 and other reports on file with the Securities and Exchange Commission.

Report of Independent Accountants

To the Board of Directors and Stockholders of Universal Stainless & Alloy Products, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and of cash flows present fairly, in all material respects, the financial position of Universal Stainless & Alloy Products, Inc., and its subsidiary (the "Company") at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, the Company adopted the provisions of the Securities and Exchange Commission's Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," in 2000.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Pittsburgh, Pennsylvania

January 18, 2002, except for Note 12,
which is as of February 14, 2002

Consolidated Statement of Operations

For the years ended December 31,	2001	2000	1999
<i>(dollars in thousands, except per share information)</i>			
Net sales	\$ 90,658	\$ 88,347	\$ 66,663
Cost of products sold	71,915	71,861	58,633
Selling and administrative expenses	6,199	4,998	4,299
Operating income	12,544	11,488	3,731
Interest expense and other financing costs	(576)	(905)	(736)
Other income (expense), net	57	(3)	30
Income before taxes and cumulative effect of accounting change	12,025	10,580	3,025
Provision for income taxes	4,386	3,970	922
Income before cumulative effect of accounting change	7,639	6,610	2,103
Cumulative effect of accounting change, net of tax	–	(1,546)	–
Net income	\$ 7,639	\$ 5,064	\$ 2,103
EARNINGS PER COMMON SHARE			
Basic			
Income before cumulative effect of accounting change	\$ 1.26	\$ 1.09	\$ 0.34
Cumulative effect of accounting change, net of tax	–	(0.26)	–
Net income	\$ 1.26	\$ 0.83	\$ 0.34
Diluted			
Income before cumulative effect of accounting change	\$ 1.25	\$ 1.09	\$ 0.34
Cumulative effect of accounting change, net of tax	–	(0.26)	–
Net income	\$ 1.25	\$ 0.83	\$ 0.34
Weighted average number of shares of Common Stock outstanding	6,080,045	6,074,701	6,110,911

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

Consolidated Balance Sheets

December 31,	2001	2000
<i>(dollars in thousands)</i>		
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 5,454	\$ 1,109
Accounts receivable (less allowance for doubtful accounts of \$434 and \$192)	13,257	12,819
Inventory	17,900	18,788
Deferred taxes	1,022	958
Other current assets	460	389
Total current assets	38,093	34,063
Property, plant and equipment, net	41,202	39,090
Other assets	151	594
Total assets	\$ 79,446	\$ 73,747
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Trade accounts payable	\$ 4,597	\$ 5,624
Outstanding checks in excess of bank balance	857	1,445
Current portion of long-term debt	1,832	1,808
Accrued employment costs	1,562	1,297
Other current liabilities	590	331
Total current liabilities	9,438	10,505
Long-term debt	6,490	8,199
Deferred taxes	7,146	6,276
Total liabilities	23,074	24,980
Commitments and Contingencies		
Stockholders' Equity		
Senior Preferred Stock, par value \$.001 per share; liquidation value \$100 per share; 2,000,000 shares authorized; 0 shares issued and outstanding	-	-
Common Stock, par value \$.001 per share; 10,000,000 shares authorized; 6,347,172 and 6,339,128 shares issued	6	6
Additional paid-in capital	25,941	25,888
Retained earnings	32,056	24,417
Treasury Stock at cost; 269,900 and 257,900 common shares held	(1,631)	(1,544)
Total stockholders' equity	56,372	48,767
Total liabilities and stockholders' equity	\$ 79,446	\$ 73,747

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

Consolidated Statement of Cash Flows

For the years ended December 31, (dollars in thousands)	2001	2000	1999
Cash flows from operating activities			
Net income	\$ 7,639	\$ 5,064	\$ 2,103
Adjustments to reconcile to net cash and cash equivalents provided by operating activities:			
Depreciation and amortization	2,782	2,466	2,101
Deferred taxes	1,087	1,509	354
Changes in assets and liabilities:			
Accounts receivable, net	(438)	(706)	(3,270)
Inventory	888	(3,058)	452
Accounts payable	(1,027)	147	2,311
Accrued employment costs	265	570	(230)
Other, net	709	293	1,146
Net cash provided by operating activities	11,905	6,285	4,967
Cash flows from investing activities			
Capital expenditures	(5,253)	(4,598)	(3,366)
Net cash used in investing activities	(5,253)	(4,598)	(3,366)
Cash flows from financing activities			
Proceeds from long-term debt	136	-	-
Long-term debt repayment	(1,821)	(1,834)	(1,117)
Borrowings under revolving line of credit	8,893	14,107	22,310
Repayments under revolving line of credit	(8,893)	(14,107)	(22,310)
Increase (decrease) in outstanding checks in excess of bank balance	(588)	338	(38)
Proceeds from issuance of Common Stock	53	50	51
Purchase of Treasury Stock	(87)	-	(1,066)
Net cash used in financing activities	(2,307)	(1,446)	(2,170)
Net increase (decrease) in cash	4,345	241	(569)
Cash and cash equivalents at beginning of period	1,109	868	1,437
Cash and cash equivalents at end of period	\$ 5,454	\$ 1,109	\$ 868
Supplemental disclosure of cash flow information			
Interest paid (net of amount capitalized)	\$ 605	\$ 827	\$ 774
Income taxes paid	\$ 3,144	\$ 1,593	\$ 388

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

Notes to the Consolidated Financial Statements

Note 1: Significant Accounting Policies

DESCRIPTION OF THE COMPANY Universal Stainless & Alloy Products, Inc. (the “Company”) manufactures and markets semi-finished and finished specialty steel products, including stainless steel, tool steel and certain other alloyed steels. The Company’s manufacturing process involves melting, remelting, treating and hot and cold rolling of semi-finished and finished specialty steels. The Company’s products are sold to rerollers, forgers, service centers and original equipment manufacturers, which primarily include the power generation and aerospace industries. The Company also performs conversion services on materials supplied by customers that lack certain of the Company’s production facilities or that are subject to their own capacity constraints.

USE OF ESTIMATES The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

BASIS OF CONSOLIDATION The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All intercompany accounts and transactions have been eliminated in consolidation.

CASH AND CASH EQUIVALENTS Cash equivalents are stated at cost plus accrued interest, which approximates market value. Cash equivalents include only securities having a maturity of three months or less at the time of purchase.

CONCENTRATION OF CREDIT RISK Financial instruments that potentially subject the Company to concentrations of credit risk are cash and cash equivalents and accounts receivable. The Company limits its credit risk associated with cash and cash equivalents by placing its investments in high-grade short-term instruments. With respect to accounts receivable, the Company limits its credit risks by performing ongoing credit evaluations and, when deemed necessary, requiring letters of credit, guarantees or collateral.

INVENTORIES Inventories are stated at the lower of cost or market with cost principally determined by the first-in, first-out (FIFO) method. The average cost method is also utilized. Such costs include the acquisition cost for raw materials and supplies, direct labor and applied manufacturing overhead. Provisions are made for slow moving inventory based upon management’s expected method of disposition.

Scrap metal together with alloy additives, principally nickel, chrome and molybdenum, currently account for more than 35% of the Company’s total cost of products sold. A substantial portion of the alloy additives is available only from foreign sources, some of which are located in countries that may be subject to unstable political and economic conditions. Those conditions might disrupt supplies or affect the prices of the raw materials used by the Company. The Company maintains sales price surcharges to help offset the impact of raw material price fluctuations.

Included in inventory are operating materials consisting of production molds and rolls that will normally be consumed within one year.

PROPERTY, PLANT AND EQUIPMENT Property, plant and equipment are recorded at cost. Costs incurred in connection with the construction or major rebuild of facilities, including interest directly related to the project, are capitalized as construction in progress. No depreciation is recognized on these assets until placed in service. Maintenance and repairs are charged to expense as incurred, and costs of improvements and renewals are capitalized. Major maintenance costs are expensed in the same annual period as incurred; however, the estimated costs are expensed throughout the year on a pro rata basis.

Depreciation and amortization are computed using the straight-line method based on the estimated useful lives of the related assets. The estimated useful lives of plant and equipment range from three to twenty years. Depreciation expense for fiscal year 2001, 2000 and 1999 is \$2,764,000, \$2,448,000 and \$2,083,000, respectively.

The Company's manufacturing processes are dependent upon certain pieces of specialty steelmaking equipment, such as the Company's electric arc furnace and universal rolling mill. In the event a critical piece of equipment should become inoperative as a result of an unexpected equipment failure, there can be no assurance that the Company's operations would not be substantially curtailed.

SFAS 121 IMPAIRMENT Long-lived assets, including property, plant and equipment are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in relation to the operating performance and future undiscounted cash flows of the underlying assets. Adjustments are made if the sum of expected future cash flows is less than book value. Based on management's assessment of the carrying values of such long-lived assets, no impairment reserve has been deemed necessary as of December 31, 2001 and 2000.

CAPITALIZATION OF SOFTWARE COSTS Direct costs incurred in the development and implementation of internal-use software is capitalized and amortized on a straight-line basis over its anticipated useful life, which generally does not exceed three years.

REVENUE RECOGNITION Revenue from the sale of products is recognized when both risk of loss and title has transferred to the customer, which in most cases coincides with shipment of the related products. Revenue from conversion services is recognized when the performance of the service is complete.

INCOME TAXES Deferred income taxes are provided for the tax effect of temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. The Company uses the liability method to account for income taxes, which requires deferred taxes to be recorded at the statutory rate expected to be in effect when the taxes are paid. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the asset will not be realized.

EARNINGS PER COMMON SHARE Basic earnings per common share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share is computed by dividing net income by the weighted-average number of common shares outstanding plus all dilutive potential common shares outstanding during the period. Dilutive common shares are determined using the treasury stock method. Under the treasury stock method, exercise of options and warrants are assumed at the beginning of the period when the average stock price during the period exceeds the exercise price of outstanding options and warrants and, common shares are assumed issued. The proceeds from exercise are assumed to be used to purchase common stock at the average market price during the period. The incremental shares to be issued are considered to be the dilutive potential common shares outstanding.

ACCOUNTING CHANGE In 2000, the Company changed its method of accounting for revenue recognition in accordance with the provisions of the Securities and Exchange Commission's ("SEC") Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." SAB 101, required to be adopted retroactive to January 1, 2000, outlined certain criteria that must be met to recognize revenue. As a result of the adoption of SAB 101, the Company determined that the application of the SEC's guidance to the language that existed in the Company's Standard Terms and Conditions of Sale required the Company to defer revenue recognition until cash was collected, even though risk of loss transferred to the buyer at time of shipment. This had the effect of deferring certain 1999 sale transactions aggregating \$12,462,000 into 2000. The cumulative effect of this change in accounting principle was a charge of \$1,546,000, net of tax benefits of \$928,000. Pro forma earnings per share amounts for the year ended December 31, 1999, assuming SAB 101 had been applied retroactively, is as follows:

	As Reported	Pro Forma
<i>(dollars in thousands, except per share information)</i>		
Net income	\$ 2,103	\$ 1,854
Basic earnings per share	\$ 0.34	\$ 0.30
Diluted earnings per share	\$ 0.34	\$ 0.30

NEW ACCOUNTING PRONOUNCEMENTS Financial Accounting Standards Board (“FASB”) Statement No. 133, “Accounting for Derivative Instruments and Hedging Activities” was issued in June 1998, and amended in June 1999 and in June 2000, pursuant to FASB Statement No. 137, “Accounting for Derivative Instruments and Hedging Activities: Deferral of the Effective Date of FASB Statement No. 133” and FASB Statement No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities: an amendment of FASB No. 133,” respectively. These statements require that an entity recognize certain derivative instruments as either assets or liabilities in the statement of financial position and measure those instruments at fair value. The adoption of these statements on January 1, 2001, did not impact the Company’s results of operations or financial condition.

In July 2001, the FASB issued Statement No. 141, “Business Combinations” and Statement No. 142, “Goodwill and Other Intangible Assets.” In August 2001, the FASB issued Statement No. 143, “Accounting for Asset Retirement Obligations.” In October 2001, the FASB issued Statement No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” These statements will be adopted in 2002 and are not expected to impact the Company’s results of operations or financial condition.

Note 2: Inventory

The major classes of inventories are as follows:

December 31,	2001	2000
<i>(dollars in thousands)</i>		
Raw materials and supplies	\$ 1,880	\$ 1,695
Semi-finished and finished steel products	13,593	13,916
Operating materials	2,427	3,177
Total inventory	\$ 17,900	\$ 18,788

Note 3: Property, Plant and Equipment

Property, plant and equipment consists of the following:

December 31,	2001	2000
<i>(dollars in thousands)</i>		
Land and land improvements	\$ 822	\$ 822
Buildings	4,701	3,889
Machinery and equipment	43,572	39,838
Construction in progress	2,641	2,311
	51,736	46,860
Accumulated depreciation	(10,534)	(7,770)
Property, plant and equipment, net	\$ 41,202	\$ 39,090

Property, plant and equipment includes a capital lease with Armco, which merged with and into AK Steel in 1999 (“Armco”), for the land and certain buildings and structures located in Bridgeville (the “Bridgeville Lease”). The Bridgeville Lease is for a ten-year term which commenced on August 15, 1994, with three five-year options to renew on the same terms at the Company’s discretion at a rental of \$1 per year plus payment of real and personal property taxes and other charges associated with the property. The Company also has an option under the lease to buy substantially all of the leased premises for \$1 at any time during the term of the Bridgeville Lease prior to August 15, 2015.

Note 4: Long-Term Debt and Other Financing

Long-term debt consists of the following:

December 31,	2001	2000
<i>(dollars in thousands)</i>		
PNC Term Loan	\$ 6,500	\$ 7,900
Government debt	1,598	1,922
Capital lease obligations	224	185
	8,322	10,007
Less amounts due within one year	(1,832)	(1,808)
Total long-term debt	\$ 6,490	\$ 8,199

On June 29, 2001, the Company entered into a third amendment to the second amended and restated credit agreement with PNC Bank which extended the term of the \$6.5 million revolving credit facility ("PNC Line") to April 30, 2003. This credit agreement, which also includes a term loan ("PNC Term Loan") scheduled to mature in June 2006, is collateralized by substantially all of the Company's assets.

Interest on borrowings under the PNC Line and the PNC Term Loan is based on short-term market rates, which may be further adjusted based upon the Company maintaining certain financial ratios. The PNC Term Loan currently bears interest at a rate equal to the Euro-dollar rate plus an interest rate spread not to exceed 175 basis points. As a condition of the PNC Line and the PNC Term Loan, the Company is required to maintain certain levels of net worth, working capital and other financial ratios; to limit the amount of capital expenditures it may incur without PNC Bank's approval; and to restrict the payment of dividends.

The Company has entered into several separate loan agreements with the Commonwealth of Pennsylvania's Department of Commerce aggregating \$1,600,000 with terms ranging from seven to twenty years. In 1996, the Company entered into a ten-year loan agreement with the Redevelopment Authority of Allegheny County Economic Development Fund in the amount of \$1,514,000. The loans bear interest at rates ranging from 5% to 6% per annum.

Scheduled maturities of long-term obligations for the next five years are as follows:

<i>(dollars in thousands)</i>	
2002	1,832
2003	1,723
2004	1,662
2005	1,747
2006	1,042
Thereafter	316

Note 5: Income Taxes

Components of the provision for income taxes are as follows:

For the years ended December 31,	2001	2000	1999
<i>(dollars in thousands)</i>			
Current provision:			
Federal	\$ 3,160	\$ 2,461	\$ 512
State	139	-	56
	3,299	2,461	568
Deferred provision (benefit):			
Federal	903	1,238	457
State	184	271	(103)
	1,087	1,509	354
Provision for income taxes	\$ 4,386	\$ 3,970	\$ 922

The income tax benefit resulting from recording the cumulative effect on prior years due to the change in revenue recognition policy was \$928,000.

A reconciliation of the federal statutory tax rate and the Company's effective tax rate is as follows:

For the years ended December 31,	2001	2000	1999
Federal statutory tax	34.0%	34.0%	34.0%
State income taxes, net of federal benefit	2.3	3.3	(2.2)
Other, net	0.2	0.2	(1.3)
Effective tax rate	36.5%	37.5%	30.5%

Deferred taxes result from the following:

December 31,	2001	2000
<i>(dollars in thousands)</i>		
Deferred tax assets:		
Receivables	\$ 187	\$ 77
Inventory	600	736
Net operating loss carry forwards	—	281
Accrued liabilities	235	145
	<u>\$ 1,022</u>	<u>\$ 1,239</u>
Deferred tax liabilities:		
Property, plant and equipment	\$ 7,146	\$ 6,276

Note 6: Stockholders' Equity

	Common Shares Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Shares	Treasury Stock
<i>(dollars in thousands)</i>						
Balance at December 31, 1998	6,320,036	\$ 6	\$ 25,787	\$ 17,250	75,000	\$ (478)
Common Stock issuance under Employee Stock Purchase Plan	10,380		51			
Purchase of Treasury Stock					182,900	(1,066)
Net income				2,103		
Balance at December 31, 1999	6,330,416	6	25,838	19,353	257,900	(1,544)
Common Stock issuance under Employee Stock Purchase Plan	8,712		50			
Net income				5,064		
Balance at December 31, 2000	6,339,128	6	25,888	24,417	257,900	(1,544)
Common Stock issuance under Employee Stock Purchase Plan	8,044		53			
Purchase of Treasury Stock					12,000	(87)
Net income				7,639		
Balance at December 31, 2001	6,347,172	\$ 6	\$ 25,941	\$ 32,056	269,900	\$ (1,631)

On October 19, 1998, the Company's Board of Directors authorized a stock repurchase program. Under the program, the Company may repurchase up to 315,000 shares, or approximately 5%, of the Company's Common Stock in open market transactions at market prices. At December 31, 2001, the Company is authorized to repurchase 45,100 additional shares of the Company's Common Stock.

The Company has 2,000,000 authorized shares of Senior Preferred Stock. At December 31, 2001 and 2000, there were no shares issued or outstanding.

Note 7: Basic and Diluted Earnings Per Common Share

The computation of basic and diluted earnings per share for the years ended December 31, 2001, 2000 and 1999 is performed as follows:

	2001		2000		1999	
	Income	Shares	Income	Shares	Income	Shares
<i>(dollars in thousands, except share amounts and per share amounts)</i>						
Income available to common Stockholders	\$ 7,639	6,080,045	\$ 5,064	6,074,701	\$ 2,103	6,110,911
Effect of dilutive securities		17,379		5,057		-
Income available to common Stockholders plus assumed conversion	\$ 7,639	6,097,424	\$ 5,064	6,079,758	\$ 2,103	6,110,911
Basic earnings per common share						
Income before cumulative effect of accounting change	\$ 1.26		\$ 1.09		\$ 0.34	
Net income	\$ 1.26		\$ 0.83		\$ 0.34	
Diluted earnings per common share						
Income before cumulative effect of accounting change	\$ 1.25		\$ 1.09		\$ 0.34	
Net income	\$ 1.25		\$ 0.83		\$ 0.34	

Note 8: Stock Compensation Plans

At December 31, 2001, the Company has two stock-based compensation plans that are described below:

INCENTIVE COMPENSATION PLAN

On September 23, 1994, the Company's Board of Directors adopted the Company's 1994 Stock Incentive Plan as amended (the "1994 Plan") for the purpose of issuing stock options to non-employee directors, other than those directors owning more than 5% of the Company's outstanding Common Stock, officers and other key employees of the Company who are expected to contribute to the Company's future growth and success. Under the 1994 Plan, the Company may grant options up to a maximum of 650,000 shares of Common Stock. Options granted to non-employee directors vest over a three-year period, and options granted to employees vest over a four-year period. All options under the 1994 Plan will expire no later than ten years after the grant date.

A summary of the 1994 Plan activity as of and for the years ended December 31, 2001, 2000 and 1999 is presented below:

	2001		2000		1999	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Fixed options						
Outstanding at beginning of year	522,500	\$ 9.58	482,500	\$ 9.79	488,500	\$ 10.10
Granted	100,000	8.22	40,000	7.13	40,000	6.06
Exercised	-	-	-	-	-	-
Forfeited	(5,000)	9.88	-	-	(46,000)	9.90
Outstanding at end of year	617,500	\$ 9.36	522,500	\$ 9.58	482,500	\$ 9.79
Options exercisable at year-end	472,746		414,287		364,165	
Weighted-average fair value of options granted during the year		\$ 4.07		\$ 3.63		\$ 2.89

The following table summarizes information about stock options outstanding at December 31, 2001.

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$6.06 to \$12.25	617,500	6.0	\$ 9.36	472,746	\$ 9.82

EMPLOYEE STOCK PURCHASE PLAN

Under the 1996 Employee Stock Purchase Plan, the Company is authorized to issue up to 90,000 shares of Common Stock to its full-time employees, nearly all of whom are eligible to participate. Under the terms of the plan, employees can choose as of January 1 and July 1 of each year to have up to 10% of their total earnings withheld to purchase shares of the Company's Common Stock. The purchase price of the stock is 85% of the lower of its beginning-of-the-period or end-of-the-period market prices. At December 31, 2001, the Company has issued 45,539 shares of Common Stock since the plan's inception.

The Company applies Accounting Principles Board Opinion 25 and related Interpretations in accounting for its stock-based compensation plans. Accordingly, no compensation cost has been recognized for its fixed stock option plan and its stock purchase plan. Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value of the awards at the grant dates in accordance with Financial Accounting Standards Board Statement 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

For the years ended December 31,	2001	2000	1999
<i>(dollars in thousands, except per share amounts)</i>			
Net income			
As reported	\$ 7,639	\$ 5,064	\$ 2,103
Pro forma	\$ 7,508	\$ 4,714	\$ 1,704
Basic earnings per share			
As reported	\$ 1.26	\$ 0.83	\$ 0.34
Pro forma	\$ 1.23	\$ 0.78	\$ 0.28

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants issued in 2001, 2000 and 1999 respectively; dividend yield of 0.0% for each year; interest rate of 5.0%, 6.0% and 6.0%; expected volatility of 50.0%, 50.0% and 45.0%; and expected lives for options of five years.

CASH-INCENTIVE PLANS

The Company has a management cash-incentive plan covering certain key executives and employees and profit-sharing plans that cover the remaining employees. The profit-sharing plans provide for the sharing of pre-tax profits in excess of specified amounts. For the years ended December 31, 2001, 2000 and 1999, the Company expensed \$1,949,000, \$1,328,000 and \$445,000, respectively, under these plans.

Note 9: Retirement Plans

The Company has defined contribution retirement plans that cover substantially all employees. The Company accrues its contributions to the hourly employee plan based on time worked while contributions to the salaried plan are accrued as a fixed amount per month. Company contributions to both plans are funded periodically. The total expense for the years ended December 31, 2001, 2000 and 1999 was \$413,000, \$320,000 and \$284,000, respectively.

No other post-retirement benefit plans exist.

Note 10: Commitments and Contingencies

The Company, as well as other steel companies, is subject to demanding environmental standards imposed by federal, state and local environmental laws and regulations. In connection with the 1994 acquisition of the Bridgeville facility assets from Armco, Armco agreed to retain responsibility for liabilities asserted against it under environmental laws with respect to environmental conditions existing at the Bridgeville facility prior to commencement of the Bridgeville Lease on August 15, 1994, and to indemnify the Company up to \$6.0 million in the aggregate over ten years. Such indemnification expires on August 15, 2004.

In connection with the Company's June 2, 1995 agreement with Armco to purchase certain assets and a parcel of real property located at Titusville, Armco agreed to indemnify the Company up to \$3.0 million in the aggregate for liabilities under environmental laws arising out of conditions on or under the Titusville property existing prior to June 2, 1995. Armco's obligation to indemnify the Company for any liabilities arising out of environmental conditions existing off-site as of June 2, 1995, is not subject to the \$3.0 million limitation.

Management is not aware of any financial difficulties being experienced by AK Steel, as successor to Armco, that would prevent its performance under the acquisition agreements. In addition, management is not aware of any environmental conditions or the incurrence of other liabilities at the Bridgeville or Titusville facilities, for which Armco has agreed to indemnify the Company, nor of any material environmental condition requiring remediation and affecting the Company.

The Company maintains insurance for both property damage and business interruption applicable to its production facilities, including the universal rolling mill.

The Company maintains a supply contract agreement with Talley Metals Technology, Inc., a subsidiary of Carpenter Technology Corporation, which is currently effective through December 2002. Under terms of the agreement, the Company will supply Talley Metals with an average of 1,250 tons of stainless reroll billet products per month. The value of the contract on a monthly basis will depend on product mix and key raw material prices.

Note 11: Segment and Related Information

The Company is comprised of two operating locations, the Bridgeville facility and the Titusville facility, and one corporate headquarters. The nature of the products and services, production processes, customer type and distribution methods are generally similar for both operating locations. In addition, the assessment of performance and allocation of resources is performed by the chief operating decision-maker at the corporate level rather than by operating location. As such, the Company operates as a single segment.

The following table presents net sales by product line:

	2001	2000	1999
<i>(dollars in thousands)</i>			
Stainless steel	\$ 76,908	\$ 62,346	\$ 55,255
Tool steel	4,503	6,960	6,055
High-strength low alloy steel	3,379	2,161	1,327
High-temperature alloy steel	2,471	1,754	2,124
Conversion services	3,054	2,309	1,807
Other	343	355	95
Net sales on shipments	90,658	75,885	66,663
Effect of accounting change	—	12,462	—
Total net sales	\$ 90,658	\$ 88,347	\$ 66,663

Net sales on shipments from the Company's largest customer and its affiliates, which were generated primarily from the Bridgeville operations, approximated 32%, 39% and 48% of 2001, 2000 and 1999 net sales, respectively. Net sales on shipments from the Company's second largest customer and its affiliates, which were generated from the Bridgeville and Titusville operations, approximated 12%, 6% and 6% of 2001, 2000 and 1999 net sales, respectively. The accounts receivable balances from these two customers comprised approximately 29% and 36% of total accounts receivable at December 31, 2001 and 2000, respectively.

The Company derives less than 10% of its revenues from markets outside of the United States and the Company has no assets located outside the United States.

Note 12: Subsequent Event

On February 14, 2002, the Company, through its wholly owned subsidiary, Dunkirk Specialty Steel, LLC ("Dunkirk Specialty Steel") acquired from the New York Job Development Authority ("JDA") certain assets formerly owned by Empire Specialty Steel, Inc. ("Empire") at its idled production facility located in Dunkirk, NY (the "Dunkirk facility"). The assets acquired include the inventory; property, plant and equipment; and selected intangible assets. The purchase price of \$4.0 million will be funded with \$1.0 million in cash, paid at closing, and ten-year, 5% interest bearing notes payable to the JDA in the amount of \$3.0 million. No principal or interest payments are payable during the first year. The Company will not assume any liabilities of Empire. Capital expenditures are expected to approximate \$6.0 million at the Dunkirk facility in 2002.

Note 13: Quarterly Financial Data (unaudited)

In 2000, the Company adopted the provisions of SAB 101 retroactive to January 1, 2000.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<i>(dollars in thousands, except per share amounts)</i>				
2001 DATA				
Net sales	\$ 21,259	\$ 24,233	\$ 23,344	\$ 21,822
Gross profit	4,138	5,026	5,152	4,427
Operating income	2,580	3,210	3,851	2,903
Net income	1,512	1,908	2,330	1,889
Earnings per common share:				
Basic	\$ 0.25	\$ 0.31	\$ 0.38	\$ 0.31
Diluted	\$ 0.25	\$ 0.31	\$ 0.38	\$ 0.31
2000 DATA				
Net sales	\$ 17,770	\$ 18,522	\$ 18,587	\$ 33,468 ^(a)
Gross profit	3,044	2,640	3,676	7,126
Operating income	1,941	1,207	2,406	5,934
Income before cumulative effect of accounting change	1,128	622	1,273	3,587
Cumulative effect of accounting change, net of tax	(1,546)	—	—	—
Net income (loss)	\$ (418)	\$ 622	\$ 1,273	\$ 3,587
Earnings per common share:				
Basic				
Income before cumulative effect of accounting change	\$ 0.19	\$ 0.10	\$ 0.21	\$ 0.59
Cumulative effect of accounting change, net of tax	(0.26)	—	—	—
Net income (loss)	\$ (0.07)	\$ 0.10	\$ 0.21	\$ 0.59
Diluted				
Income before cumulative effect of accounting change	\$ 0.19	\$ 0.10	\$ 0.21	\$ 0.59
Cumulative effect of accounting change, net of tax	(0.26)	—	—	—
Net income (loss)	\$ (0.07)	\$ 0.10	\$ 0.21	\$ 0.59

^(a) During the fourth quarter of 2000, the Company modified its Standard Terms and Conditions of Sale to more closely reflect the substance of its sale transactions, which resulted in revenue being recorded at the time of shipment rather than when cash was received.

Price Range of Common Stock

The Common Stock is listed on the NASDAQ National Market under the symbol "USAP." The following table sets forth the range of high and low sale prices per share of Common Stock, for the periods indicated below:

	High	Low
YEAR 2001		
First quarter	\$ 8.06	\$ 7.00
Second quarter	\$ 10.40	\$ 7.19
Third quarter	\$ 10.73	\$ 6.84
Fourth quarter	\$ 8.49	\$ 6.85
YEAR 2000		
First quarter	\$ 7.56	\$ 5.69
Second quarter	\$ 7.75	\$ 5.63
Third quarter	\$ 7.19	\$ 6.38
Fourth quarter	\$ 8.25	\$ 6.69

The Company has never paid a cash dividend on its Common Stock and currently has no plans to pay dividends in the foreseeable future. The PNC Credit Agreement contains restrictions on the Company's ability to pay dividends on Common Stock.

Forward-Looking Information and Safe Harbor

This Annual Report contains historical information and forward-looking statements. 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 and the effect of new accounting pronouncements are included in this Annual Report pursuant to the "safe harbor" provision of the Private Securities Litigation Reform Act of 1995. They 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. 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. In the context of the forward-looking information provided in this Annual Report, please refer to the discussions of risk factors detailed in, as well as the other information contained in, this Annual Report and the Company's filings with the Securities and Exchange Commission during the past 12 months.

Five-Year Summary

For the years ended December 31, <i>(dollars in thousands, except per share amounts)</i>	2001	2000 ^(a)	1999	1998	1997
SUMMARY OF OPERATIONS					
Net sales	\$ 90,658	\$ 88,347	\$ 66,663	\$ 72,595	\$ 81,301
Operating income	12,544	11,488	3,731	7,566	11,574
Income before cumulative effect of accounting change	—	6,610	—	—	—
Cumulative effect of accounting change, net of tax	—	(1,546)	—	—	—
Net income	7,639	5,064	2,103	5,004	7,206
PRO FORMA SUMMARY OF OPERATIONS^(b)					
Net sales	\$ 90,658	\$ 88,347	\$ 63,330	\$ 78,170	\$ 76,229
Operating income	12,544	11,488	3,373	8,437	11,049
Net income	7,639	6,610	1,854	5,558	6,875
FINANCIAL POSITION AT YEAR-END					
Working capital	\$ 28,655	\$ 23,558	\$ 20,800	\$ 21,829	\$ 20,086
Total assets	79,446	73,747	68,179	64,450	56,151
Total debt	8,322	10,007	11,841	12,958	5,779
Stockholders' equity	56,372	48,767	43,653	42,565	37,768
COMMON SHARE DATA					
Basic earnings per share:					
As reported	\$ 1.26	\$ 0.83	\$ 0.34	\$ 0.79	\$ 1.15
Pro Forma under SAB 101 ^(b)	1.26	1.09	0.30	0.88	1.09
Diluted earnings per share:					
As reported	1.25	0.83	0.34	0.79	1.12
Pro Forma under SAB 101 ^(b)	1.25	1.09	0.30	0.87	1.07
Stockholders' equity	9.28	8.03	7.19	6.82	6.00
OTHER DATA					
EBITDA ^(c)	\$ 15,365	\$ 11,459	\$ 5,844	\$ 8,960	\$ 12,741
Capital expenditures	5,253	4,598	3,366	12,146	8,145
Depreciation and amortization	2,782	2,466	2,101	1,516	1,109
Return on stockholders' equity	13.6%	10.4%	4.8%	11.8%	19.1%
Debt to total capitalization	12.9	17.0	21.3	23.3	13.3
Employees	304	280	277	280	270
Customers	288	250	235	200	167
AVERAGE SHARES OUTSTANDING <i>(in thousands)</i>					
Basic	6,080	6,075	6,111	6,305	6,286
Diluted	6,097	6,080	6,111	6,355	6,417

^(a) Includes \$12,462,000 of net sales and \$9,988,000 of costs of sales associated with revenues recognized in 1999 but deferred until 2000 as a result of implementing Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements." The 2000 results of operations also include the impact of changing the Company's Standard Terms and Conditions to more closely reflect the substance of its sales transactions.

^(b) Includes the effect of implementing Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" as required under generally accepted accounting principles in 2000.

^(c) Represents earnings before special charges, interest expense, income taxes and depreciation and amortization.

Directors

DOUGLAS M. DUNN

Dean of Graduate School
of Industrial Administration
Carnegie Mellon University

GEORGE F. KEANE

President Emeritus
Common Fund Group

CLARENCE M. McANINCH

President and Chief Executive Officer
Universal Stainless & Alloy Products, Inc.

UDI TOLEDANO

President
Millennium 3 Capital, Inc.

D. LEONARD WISE

Former President and Chief Executive Officer
Carolina Steel Corporation

Officers

CLARENCE M. McANINCH

President and Chief Executive Officer

RICHARD M. UBINGER

Vice President of Finance,
Chief Financial Officer and Treasurer

PAUL A. McGRATH

Vice President of Operations,
General Counsel and Secretary

Management

MICHAEL J. OBIECUNAS

Director, Employee Relations

BRUCE A. KRAMER

Director, Purchasing and Production Planning

KEITH A. ENGLEKA

Director, Technology

DAVID M. BLANCHARD

Manager, PRP Division

Corporate Information

EXECUTIVE OFFICES

Universal Stainless & Alloy Products, Inc.
600 Mayer Street
Bridgeville, PA 15017
Telephone: 412-257-7600

ANNUAL MEETING

The Annual Meeting of Stockholders will be held at 10 a.m. on Tuesday, May 21, 2002, at the Southpointe Golf Club, Canonsburg, PA.

STOCKHOLDER INFORMATION

Universal Stainless & Alloy Products, Inc.'s Annual Report, Form 10-K and other reports filed with the Securities and Exchange Commission can be obtained, without charge, by writing to the Vice President of Finance at the Executive Offices.

TRANSFER AGENT AND REGISTRAR

Continental Stock Transfer & Trust Company
2 Broadway
New York, NY 10004

STOCK LISTING

NASDAQ Symbol: USAP

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