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Reliance Steel & Aluminum Co. NYSE:RS

FQ3 2015 Earnings Call Transcripts

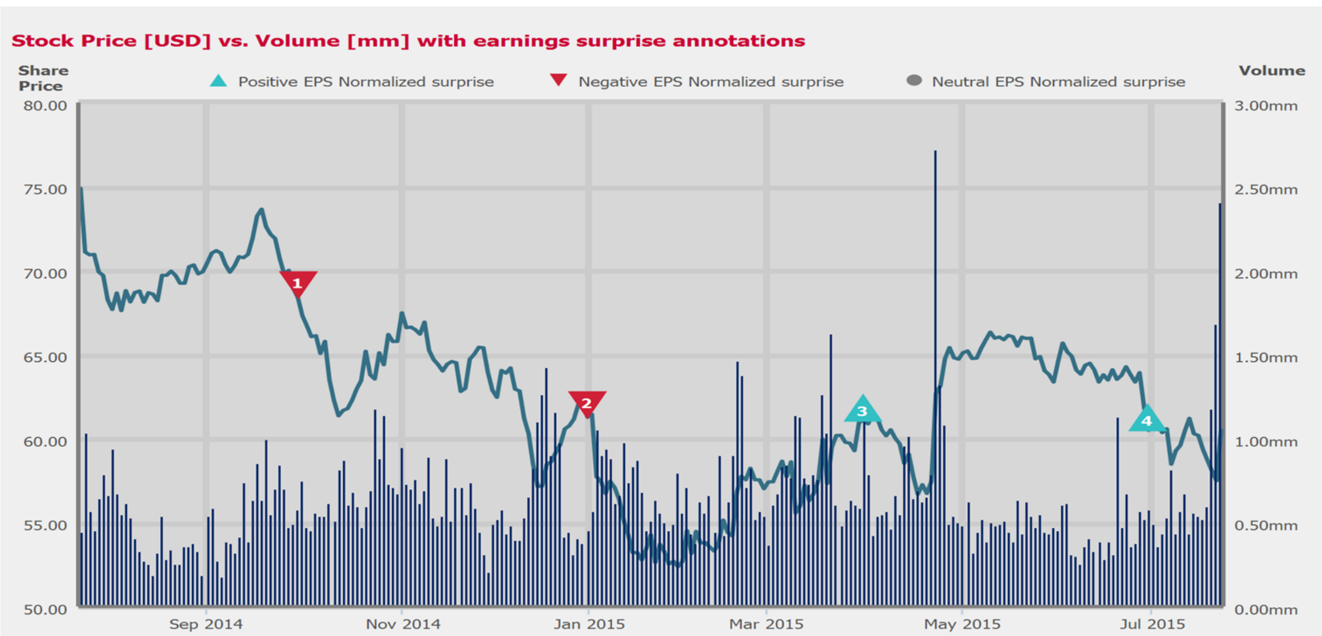
Thursday, October 22, 2015 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2015-			-FQ4 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.02	1.16	▲13.73	0.93	4.48	5.21
Revenue (mm)	2365.85	2286.20	▼(3.37 %)	2310.71	9702.81	10048.27

Currency: USD

Consensus as of Oct-22-2015 3:09 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2014	1.34	1.33	▼1 (0.75 %)
FQ4 2014	1.06	1.01	▼2 (4.72 %)
FQ1 2015	1.02	1.30	▲3 27.45 %
FQ2 2015	1.11	1.21	▲4 9.01 %

Call Participants

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Vice President of Corporate Initiatives

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Executive Chairman

Gregg J. Mollins
Chief Executive Officer, President and Director

James D. Hoffman
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Karla R. Lewis
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Presentation

Operator

Greetings, and welcome to the Reliance Steel Third Quarter 2015 Financial Results Conference Call. [Operator Instructions] As a reminder, this conference is being recorded. I would now like to turn the conference over to Ms. Brenda Miyamoto, Investor Relations. Thank you, Ms. Miyamoto. You may now begin.

Brenda Miyamoto
Vice President of Corporate Initiatives

Thank you, operator. Good morning, and thanks to all of you for joining our conference call to discuss our third quarter 2015 financial results. I'm joined by Gregg Mollins, our President and CEO; Karla Lewis, our Senior Executive Vice President and CFO; and our Executive Vice President of Operations, Jim Hoffman and Bill Sales. David Hannah, our Executive Chairman, will also be available during the question-and-answer portion of this call.

A recording of this call will be posted on the Investors section of our website at investor.rsac.com.

The press release and the information on this call contains certain forward-looking statements, which are based on a number of assumptions that are subject to change and involve known and unknown risks, uncertainties or other factors, which may not be under the company's control, which may cause the actual results, performance or achievement of the company to be materially different from the results, performance or other expectations implied by these forward-looking statements. These factors include, but are not limited to, those factors disclosed in the company's annual report on Form 10-K for the year ended December 31, 2014, under the caption Risk Factors and other reports filed with the Securities and Exchange Commission. The press release and the information on this call speak only as of today's date, and the company disclaims any duty to update the information provided therein and herein.

I will now turn the call over to Gregg Mollins, President and CEO of Reliance.

Gregg J. Mollins
Chief Executive Officer, President and Director

Good morning, everyone, and thank you for joining us today. Once again, our operational performance was outstanding despite significant industry-wide challenges that continue to put pressure on metal pricing. In particular, I am very pleased that we were able to increase our FIFO gross profit margins to 26.4%, up 70 basis points from the prior quarter and up 100 basis points from the first quarter of 2015. Our ability to increase our gross profit margin sequentially in each quarter of 2015, in an environment with metal pricing falling each month, reflects exceptional execution by our managers in the field. Our business model of focusing on smaller orders that require quick turnaround along with providing high levels of value-added processing coupled with our disciplined operational execution, resulted in non-GAAP earnings of $1.16 per diluted share, well ahead of our guidance range. Overall, customer demand remained relatively strong with our tons sold per day increasing sequentially each month of the quarter. The typical seasonal trend is for the third quarter volume to decline 3% to 5% from the second quarter. However, in line with our expectations, our third quarter tons sold were down only 1.5% from the second quarter, and once again we outperformed the industry with the MSCI average down 2.9%. Although we sensed some hesitation in the market at this time, mainly due to recent announcements about slower growth in China, resulting an even further downward pressure on metal pricing, we believe customer demand across our business is relatively healthy outside of the energy industry. We continue to increase our market share by providing high levels of customer service as well as investing in our people and our businesses. We have made and will continue to make significant investments in our businesses that perform toll processing work for the auto industry as this is highly profitable for us and we have no metal price risk. Our primary growth, relative to the auto industry in the U.S., has been due to the increased aluminum usage in autos and trucks, which we believe will continue. Reliance is very well-positioned to further grow our participation in this area. We have also increased our presence in aerospace distribution through an acquisition in August 2014 as well as opening new facilities for our companies serving this market. These investments have expanded and strengthened our ability to service our aerospace customers on a global basis, and we anticipate continued growth in the aerospace market. Our business model positions us well to increase our market share in the current environment. As our customers typically place orders for smaller quantities on a more frequent basis when metal prices are declining. This is Reliance's sweet spot. As our decentralized structure allows us to respond to small quick turnaround orders.

Demand for our products was in line with our expectations for the quarter, but we stay significant headwinds from continued pricing pressure across all the metals we sell with the exception of aerospace play. Going into the quarter, we had expected prices to be stable to up slightly; however, conditions softened even further, and as a result, our average selling price per ton sold was down 4.4% compared to the prior quarter and 12.7% compared to the third quarter of 2014. Given the weak global economy and a strong U.S. dollar, imports continued to flood the U.S. market and raw material costs continued to fall. So far in the fourth quarter, domestic metal pricing has continued to decline. At this time, we do not see any meaningful near-term catalyst to change the direction of pricing. That said, we remain highly focused on managing all aspects of the business that are within our control, which continues to offset much of the impact on our profitability from the weak pricing environment.

During 2015, we have made a concerted effort to lower inventory levels and I am pleased to report that year-to-date, we have decreased our FIFO inventory by $239.8 million, including $120.5 million during the third quarter. Inventory turns a key area of focus for Reliance, improved to 4.7x based on our FIFO inventory turns on hand at September 30, 2015. And our first 9 months of 2015 shipment levels, which is near our companywide goal of 4.75x. Not only did this provide cash that we used to reduce our debt by $106.1 million and to repurchase $142.3 million of our stock, I also believe that our improved inventory position contributed to our increased gross profit margins.

I would like to personally thank all of our employees who helped achieve these results. Another example of our focus on the controllable aspects of our business is our effective expense management. Over the years, Reliance has consistently demonstrated our ability to quickly respond to changing market factors. We started to reduce expenses and inventory at our businesses that focus on the energy market when we first began to sense a slowdown towards the end of 2014. Because of this quick reactions, our energy-focus businesses, as a whole, were profitable for the nine-month period ended September 30, 2015. During the period, when our volumes in these businesses decreased over 40%, the only way to achieve this is by attacking your costs quickly. In line with our quick reactions, changing market conditions, we recorded an impairment and restructuring charge of $55.5 million during the quarter, given our updated outlook that oil prices remain depressed for longer than we had previously anticipated, which is expected to reduce both volume and profitability of our energy businesses. This charge includes closing a few of our locations, while we regret any hardships this may cause on our employees, we believe these are necessary actions to enhance our overall operating efficiencies and long-term profitability. We will continue to be vigilant in assessing energy and market demand trends and will take further actions as necessary.

In the third quarter last year, we completed the acquisition of Northern Illinois Steel Supply and All Metal Services followed by the fourth quarter 2014 acquisition of Fox Metals and Alloys. These acquisitions contributed to our third quarter 2015 consolidated net sales of $2.29 billion. In total, we sold 1.49 million tons of metal during the third quarter of 2015. While we have not completed any acquisition so far in 2015, we continue to see and evaluate many opportunities. Reliance is regarded as the acquirer's choice throughout our industry and M&A remains an integral part of our overall growth strategy. We expect to continue to be a consolidator in our highly fragmented industry by making strategic acquisitions of well-managed metal service centers and processors with the end market exposures that support our diversification strategy.

To sum up the quarter, I'm extremely proud of our performance. We increased our FIFO gross profit margins to 26.4%. We reduced our inventory by $120.5 million. Our cash flow from operations was $252.4 million. We paid down a $106.1 million of debt and we repurchased a $142.3 million of our common stock.

We have a very experienced team at Reliance, that again achieved industry-leading operating results in a very difficult environment. Our strong performance improved our balance sheet and liquidity position, which provides a strong foundation for us to continue to grow our business through M&A and organic initiatives, while at the same time, deleveraging our balance sheet and returning value to our shareholders through dividends and opportunistic share repurchases. I thank all of our employees, customers, suppliers and shareholders for our success, and I remain confident in our ability to continue our track record of success going forward.

I will now hand the call over to Jim to comment further on operations and market conditions. Jim?

James D. Hoffman
Executive Vice President of Operations

Thanks, Greg, and good morning, everyone. I'm going to speak mainly about pricing and demand for our carbon steel and alloy products as well as our outlook on certain key markets we sell those products into. Bill will then address our aluminum and stainless steel markets. I would like to add to the Greg's comments about how proud we are of our operational execution during the quarter. First, I'll comment on several of our key end markets. Automotive, that we service mainly through our toll processing operations in the U.S. and Mexico, has shown consistent strength throughout 2015 and we expect that trend to continue. Our growth in this end market in the U.S. has outpaced the general industry growth, primarily due to incremental processing volume from increased aluminum usage in the automotive market. This is new business for us, made possible by our expertise in hard-to-do processing as well as our ability to make significant investments in new equipment and facilities to support this growth. Even though we're just ramping up for this new business, we have already processed double the amount of aluminum we processed last year of our toll processing operations. And as we discussed on prior calls, we are breaking ground on a new facility in Mexico to expand our existing toll processing capacity to support the increased automotive activity in that area. We expect this facility to be operational by mid-2016. As a reminder, our toll processing operations are not impacted by metals pricing. As we process the metal for a fee without taking ownership of the metal. This provides consistent returns, and although toll processing represents a small portion of our total sales dollars, it represents a larger percentage of our profitability. That's why we're so excited about this growth.

Moving on into heavy industry, which includes railcar, truck trailer, ship building, barge manufacturing, tank manufacturers and wind and transmission towers demand for this quarter remained fairly steady with the prior quarter. Our exposure to heavy equipment also includes sales into the agricultural equipment market, which has weakened recently, but has not impacted us the same -- to the same extent as our OEMs. On a positive note, demand in the construction equipment market is trending up. Non-residential construction is our largest end market, and although we have been experiencing continued modern improvement and demand over the course of the year, our volume remains well below the peak levels. We expect positive growth in 2016 with the potential of some pullback activity during the fourth quarter of 2015. We have made strategic investments in our businesses servicing this space since 2009 rather than scaling back or closing facilities, as we believe this market for us will eventually return to prerecession levels. Our investments include processing equipment that will enable us to provide a higher level of value-added processing to our customers as their volumes increase, which can easily be absorbed in our existing cost structure.

Turning to energy, that being oil and natural gas. Our third quarter volumes sold and our businesses servicing the energy market actually increased a bit from the prior quarter, mainly due to normal seasonal patterns in certain of our markets where we sell heavier products. Compared to the third quarter of 2014, our volumes were down 44%. In our opinion, the overall energy market deteriorated further in the third quarter from the second quarter, which continued downward pressure on both pricing and activity levels due to low oil prices and the related reduction in drilling activities. Because our managers in the field reacted quickly and had continued to curb expenses throughout the year, mainly through headcount reduction, our energy businesses as a whole are profitable for the 9 months ended September 30, 2015. However, pretax income for these businesses was down about 80% or $67 million compared to the same 9-month period of 2014. We have reduced headcount at our businesses servicing the energy market by 1/3 or approximately 400 people. With our operating expense run rate for these businesses now approximately 38% lower than it was at the end of last year.

Our updated outlook, however, assumes that oil prices will remain low for longer than we had previously expected, which resulted in our decision to close a few of our underperforming locations that are solely dependent on energy customers.

Turning now to carbon and steel. Prices continued to be under a great deal of pressure in the third quarter, mainly due to continued record high import levels in the marketplace as well as a rapid decline in raw material prices, a strong U.S. dollar, a soft global economy, including a weakening Chinese market and high inventory levels throughout the supply chain. However, in this environment, we were once again able to increase our FIFO gross profit margins on sales of carbon steel products in 2015 third quarter as compared to both the 2015 second quarter and 2014 third quarter. The increased gross profit margin dollars from our carbon and steel operations largely offset our pretax income losses from our energy-focused business reflecting the importance of Reliance's diversification strategy.

Plate represents the largest portion of our product mix followed by carbon steel structures, bars and tubing. Therefore, our results are more impacted by pricing on these products versus carbon flat-rolled products, which represent only 15% of our total sales with hot-rolled at 7%. Flat-rolled pricing has been under pressure for over a year now with mills down over 30% since the beginning of 2015. Although plate demand remains fairly healthy, pricing for plate products has declined significantly, down over 40% from the beginning of 2015, and we expect further pressure for the balance of the year.

Base prices for alloy products, a majority of which are sold into our energy end market has held up while considering the significant reduction in demand. Going forward, we expect prices for these products to remain fairly steady with current levels due to in large part, to the product going into the automotive market. I will now turn the call over to Bill for comments on our nonferrous markets. Bill?

William K. Sales
Executive Vice President of Operations

Thanks, Jim. Good morning, everyone. The aerospace market continues to represent one of our strongest end markets from a demand perspective, with our same-store tons sold up 7.6% in the 9 months ending September 30, 2015. We remain very bullish on the aerospace market as build rates in the commercial airline market continued to grow. As Greg mentioned, we've increased our aerospace presence in new geographies through our acquisition of All Metal Services, headquartered in the U.K. in August of 2014, as well as opening 2 new AMI Metals Facilities in France and Turkey in the first quarter of 2015. Sales to the aerospace market have increased as a percentage of our total sales, now representing nearly 10% in the third quarter of 2015. We believe Reliance remains very well-positioned to gain market share in this area on a global basis.

Earlier this week, we announced that we were awarded the contract for aluminum flat-rolled product to be supplied to the F-35 joint strike fighter program. This contract runs from 2017 through 2021 and is estimated at $300 million. The majority of the products that we sell to the aerospace market are heat-treated aluminum products, especially plate as well as specialty stainless steel and titanium products. Given strong underlying demand, pricing for aerospace aluminum plate has increased with two price increases announced this year. Lead times for the domestic suppliers of aerospace plate have moved from the 24 to 28 weeks reported last quarter to a controlled order entry process. Lead times for the nondomestic suppliers are currently in the 24- to 28-week time frame, and we believe they too are moving toward a controlled order entry process. Both price increases announced this year have held and the product is in tight supply. Our sales of common alloy aluminum remain consistent from a volume standpoint with most of our product being sold to sheet metal fabricators that support a variety of end markets. Demand on general engineering aluminum plate remain solid with domestic lead times around 20 to 25 weeks, yet pricing remains challenged, especially with ongoing aggressive import pricing. Demand for semiconductor plate has been strong and is expected to remain steady for the balance of the year.

Pricing on common alloy aluminum sheet follows ingot and has deteriorated from prior year levels due to increased imports as well as a significant reduction in the Midwest premium. Midwest spot ingot has been trading in the $0.75 to $0.80 per pound range, down from the $1.06 per pound in January. The Midwest premium was at historically high levels for longer than we had anticipated, but is now decreased about $0.17 per pound since the beginning of the year. Outside of the energy market, demand for stainless steel products has continued to be good despite very challenging pricing, primarily related to stainless flat-rolled. We sell a significant amount of stainless steel flat products into the kitchen equipment, appliance and construction end markets. Lead times are about 3 to 4 weeks and we expect pricing pressures to continue for that product, in particular given the excess inventory in the supply chain. That said, stainless steel bar, which represents about 30% of our stainless steel volume, remains more profitable for us. Pricing for flat-rolled stainless steel products has declined more than any other product in 2015. With September prices down about 40% from the beginning of the year, pricing for these products is heavily impacted by nickel prices, which began the year at $7.37 per pound and is currently down $2.79 per pound to $4.58 per pound for October. As an example, surcharges for 3 or 4 stainless have fallen from $0.76 per pound in January to $0.42 per pound in October. In addition, base prices have dropped by a few discount points due to a heavy influx of import products. We expect prices for stainless steel products to remain under pressure for the remainder of 2015 and into 2016. That being said, our managers in the aluminum and stainless steel portions of our business have increased their gross profit margins during a very volatile pricing environment and managed their expenses well. We applaud them for their performance. I will now turn the call over to Karla to review our third quarter financial results.

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

Thanks, Bill, and good morning, everyone. Our sales in the third quarter of 2015 were down $419 million or 15.5% from the third quarter of 2014, and down $137.5 million or 5.7% from the second quarter of 2015. The majority of the decline was due to lower prices resulting from the market conditions discussed earlier. Our same-store average selling price has declined sequentially in each month beginning in September 2014, with our September 2015 same-store average selling price down $292 per ton or 16.8% from our September 2014 average selling price. And based on our 2015 third quarter tons sold, this equates to a loss of nearly $400 million in quarterly sales or $1.6 billion per year due solely to the impact of metals pricing. Because metal prices decline more than we had anticipated in the 2015 third quarter as compared to the 2015 second quarter, we increased our estimate of our annual LIFO inventory valuation adjustment to income of $100 million compared to our prior estimate of $80 million. This resulted in a LIFO credit or income of $75 million for the 9 months ended September 30 with $35 million or $0.29 earnings per diluted share included in our cost of sales in the 2015 third quarter compared to our projected amount of $20 million or $0.17 earnings per diluted share.

We recorded LIFO income of $32.5 million or $0.27 per diluted share in the 2015 second quarter. In the 2014 third quarter, when metals prices were generally rising, we recorded a LIFO charge or expense of $20 million or $0.16 per diluted share. This adjustment reflects LIFO accounting, working in the manner intended, reducing FIFO cost of sales in a declining price environment to value inventory at current replacement cost.

Our 2015 third quarter gross profit margin of 27.9% increased from 25.1% in the 2014 third quarter and 27.1% in the 2015 second quarter. Our increased LIFO income contributed to our increased gross profit margin. On a FIFO basis, our gross profit margin during the quarter increased, exceeding our expectations especially in light of declining prices. Given the competitive market and lower prices, we had anticipated that our gross profit margins would remain relatively consistent with the prior quarter with some potential for downward pressure. However, as highlighted previously, our teams in the field did a great job of maintaining and increasing our gross profit margin. Our 2015 third quarter SG&A expenses decreased $44 million from the 2014 third quarter and $12 million from the 2015 second quarter, primarily due to effective cost control throughout the company, including reductions in workforce at our businesses servicing the energy end market.

Companywide, our headcount at September 30 was down 3.7% or 550 people compared to January 1 on a 1.7% decline in tons sold. As a percent of sales, our SG&A expenses were 18.8% compared to 17.5% in the 2014 third quarter and 18.2% in the 2015 second quarter. And the increase as a percent of sales was impacted mainly by lower selling prices in the 2015 third quarter.

As individual markets change, we will continue to remain disciplined in our efforts to adjust our variable expenses, such as personnel costs, which represent about 60% to 65% of our SG&A expenses. We are proud of our quick reaction to the significant decline in sales volumes to the energy market.

Our non-GAAP pretax income of $133.2 million was lower than of those to 2014 third quarter and the 2015 second quarter; however, our third quarter non-GAAP pretax income margin of 5.8% improved from 5.4% in the 2014 third quarter and 5.6% in the 2015 second quarter. Again, this improvement was only possible because of our excellent operational execution across all controllable aspects of our business in a very challenging environment. Our effective income tax rate in the quarter was 32.1% compared to 25.7% in the 2014 third quarter when we benefited from the resolution of certain tax matters and 32.6% in the 2015 second quarter. For the 9 months periods, our effective rate in 2015 was 32.1% compared to 32.5% in the 2014 period, down slightly as we are benefiting from lower tax rate in certain states and foreign jurisdictions, and we currently expect that our full year 2015 effective income tax rate will be in the range of 32% to 33%.

As Greg and Jim both mentioned, we recorded a pretax income and restructuring charge of $55.5 million or $0.47 earnings per diluted share in the third quarter of 2015. This includes charges directly related to the plant closure of certain energy-related businesses, where we anticipate losses on the disposition of certain assets. In addition, we recorded charges for the write-down of intangibles due to the loss of customers and low future earnings expectations for certain of our operations servicing the energy market. These charges represented in our table of non-GAAP net income and earnings per share amounts in our press release issued earlier today. We expect the positive impact on our future earnings due to the closure of the identified locations that we're operating below our companywide pretax income levels as well as lower amortization expense from a portion of the intangible write-downs. As always, we will continue to monitor our performance at all of our businesses, not just those servicing the energy market and take appropriate actions as warranted. Net income attributable to Reliance for the 2015 third quarter was $51.4 million or $0.69 per diluted share as compared to net income of $95.5 million or $1.21 per diluted share in the 2014 third quarter. We believe our non-GAAP net income of $85.5 million or $1.16 per diluted share is a better reflection of our performance in the quarter.

We generated $252.4 million of cash from operations during the 2015 third quarter resulting in $716.3 million in cash from operation for the 9 months ended September 30. We are very proud of our ability to generate such a strong cash flow in the current market, which demonstrates the countercyclical nature of our working capital needs. Our cash generation was greatly enhanced by our efforts to drive down inventory levels during the year with an inventory reduction of $120.5 million in the third quarter and $239.8 million in the first 9 months of 2015.

On the working capital front, we continue to manage our receivables well with our accounts receivable days sales outstanding rate at September 30, 2015, of 42.3 days in line with our historical range. Our inventory churn rate at September 30, improved to 3.9x based on dollars and 4.4x or 2.7 months on hand based on tons. Given our significant inventory reductions during the year, we would like to point out that our tons based churn rate calculated on our September 30 inventory levels and year-to-date shipment levels would be 4.7x, very close to our goal of 4.75x.

We used our cash from operations to reduce our outstanding debt, invest in our businesses that are performing well and return value to our shareholders. We paid down $106.1 million of debt during this third quarter and $209.1 million in the 9-month period. At September 30, 2015, our total debt outstanding was $2.1 billion, resulting in an improved net debt-to-total capital ratio of 33.8%. As of September 30, 2015, we had $489 million outstanding on our $1.5 billion revolving credit facility. We spent $42.3 million on capital expenditures during the 2015 third quarter and $119.4 million year-to-date. Our full year 2015 CapEx budget remains $200 million, majority of which is related to organic growth initiatives, including the toll processing and aerospace activities mentioned earlier. We also take quarterly dividends of $29 million during the quarter and further enhanced our shareholder returns with share repurchases.

Given what we believe to be an undervalued share price, we have been very active repurchasing our shares this year with repurchases of $142.3 million or 2.5 million shares in the third quarter of 2015. And in the 9 months ended September 30, 2015, we repurchased $342.3 million or 5.95 million shares of our common stock at an average price of $57.50 per share. As a result of these repurchases, we realized an earnings per share benefit of $0.11 per share during the first 9 months of 2015, and on a pro forma basis, that is, if we would have repurchased all of the 5.95 million shares on January 1, the impact on earnings per share will be $0.23 for the 9 months. Because of our significant share repurchase activity in 2015, we have almost depleted our authorization under existing share repurchase program. To allow us to continue to opportunistically repurchase shares, when they are undervalued and we have available cash, our board amended our share repurchase plan and increased the authorized number of shares available to be repurchased by 7.5 million shares and extended the plan to December 31, 2018. The 7.5 million shares authorized for repurchase represents approximately 10% of our current shares outstanding. We expect to use available cash to continue to reduce our debt, support our various growth activities, pay our quarterly dividend and opportunistically repurchase shares of our common stock.

Now turning to our outlook. While we believe the U.S. economy will continue its slow growth going forward given increased uncertainty in the market at this time along with normal seasonal patterns, we are cautious in regard to both business activity levels and metal pricing in the fourth quarter of 2015. These factors, combined with 2 less shipping days in the fourth quarter, lead us to expect a decrease in tons sold of approximately 4% to 5% in the fourth quarter of 2015 over the third quarter of 2015 compared to the more typical seasonal trend of down 5% to 10%.

Metals pricing is expected to remain under pressure for most products that company sells through the remainder of 2015. Accordingly, we expect our average selling price in the fourth quarter of 2015 to be down 1% to 2% from the third quarter of 2015. As a result, we currently expect non-GAAP earnings per diluted share to be in the range of $0.75 to $0.85 for the fourth quarter ending December 31, 2015. We remain confident in our ability to continue to effectively manage the controllable aspects of our business to mitigate the volatile factors that impact our industry and/or beyond our control. We are proud of the exceptional execution by our managers in the field. Our effective working capital management and consistent gross profit margins provide strong cash flows that allow us to continue to fund growth opportunities while at the same time providing steady returns to our shareholders. That concludes our prepared remarks. Thank you for your attention. And at this time, we would like to open the call up to questions. Operator?

Question and Answer

Operator

[Operator Instructions] Our first question is from Michael Gambardella of JPMorgan.

Michael F. Gambardella
JP Morgan Chase & Co, Research Division

I have a couple of questions. One, I mean, just based on how aggressive you've been really this full year on the share buyback and how the board has increased the share buyback, is that an indication that the M&A activity coming in your door, like what the people are bringing to you? And what you're looking at has diminished even though the market kind of is towards the bottom anyway?

Gregg J. Mollins
Chief Executive Officer, President and Director

The answer to that Mike is, no. There is quite a bit of activity on the M&A front. But as you know, we've always been very selective on our acquisition strategies. They have to be accretive, and we just haven't seen anything thus far that really caught our interest. So -- but there is activity. We fully intend to keep very active in the M&A portion of our business. But as so far this year, we just haven't seen anything that we really thought would be a good addition to our group and the diversification policies that we have.

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

And Mike, we've tried to -- make it kind of clear that we've not given up anything from our capital allocation whether it be M&A, investing for organic growth, paying our dividends or repurchasing shares. We're in a position where we're still able to execute on all four of those. Unfortunately, our stock price has been at a level where we felt it was an extremely good investment for us. And so we have been more active both because of the price and also because of the available cash we've had from our really strong working capital management and the inventory reductions we've had during the year.

Michael F. Gambardella
JP Morgan Chase & Co, Research Division

Would your typical acquisition target, there will be a company that probably wouldn't want to sell at the bottom, because typically go after companies that are well-managed, need probably better balance sheet because they are well-managed, and probably don't necessarily want to fell them to bottom, would that be a true statement?

Gregg J. Mollins
Chief Executive Officer, President and Director

Yes, it would. And even though we don't value based on the highest level of times like 2008 were the lowest and 2009. We do it over a period of time and on a normalized pretax for office basis. But as a seller, if you are not doing as well as you think you should be doing or could be doing then the likelihood of you are sitting on the sideline for a period of time until your results are where your expectations lie are probably pretty good.

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

And we have, I would say, recently seen a bit more on potential opportunities out there and they are not, a lot of them aren't attractive to us as Greg said, but it does seem there has been a bit more pickup in companies that are considering selling.

Michael F. Gambardella
JP Morgan Chase & Co, Research Division

Just another question on the -- I know you said that the carbon sheet businesses was about 15%, but in that area, when you have such a significant trade case, you have 3 trade cases that, maybe represent about 15% of U.S. supply carbon sheet coming for preliminary tariffs out in the end of December into late January, do you do any preparation in terms of purchasing or not, or do you just wait and see what happens with the announcement.

James D. Hoffman
Executive Vice President of Operations

Yes, Michael, this is Jim. Yes, we don't speculate. It's too difficult to do, it's just not our part of our model. We buy for need, not for greed. The customers tell us what they are going to buy and we stock the right stuff. So we don't try to play in that game.

Gregg J. Mollins
Chief Executive Officer, President and Director

We don't anticipate anything coming forward if it's very positive on the terrace that's fantastic. But we just, as Jim pointed out, we're just totally focused on turning our inventories, and we're hopeful of good results with respect to the trade cases.

Operator

Your next question is from Anthony Rizzuto of Cowan and Company.

Anthony B. Rizzuto
Cowen and Company, LLC, Research Division

Got a couple of questions. That the first, obviously, very impressive that you guys were able to increase the FIFO margin so much of 70 basis points, and then you have done that each quarter of this year. So first question is, is that the type of performance repeatable in your view and could we see even larger gains if prices simply were to stabilize?

Gregg J. Mollins
Chief Executive Officer, President and Director

I think that 26.4% is about as good as this is going to get in my personal opinion. Okay, now Karla is looking at me cross-eyed. She may have a different opinion than that, but I think that we had a remarkable gross profit margin improvement in the third quarter. But I would not look for an improvement in the fourth quarter over the third quarter, because the seasonality, a lot of people in the fourth quarter, a lot of competitors of ours, like to dump inventories in the fourth quarter, so we're going to be faced with that headwind. There is still ample imports at all that docks throughout North America, that's not a good thing. So I wouldn't factor in any improvement in our fourth quarter gross profit margin over the third quarter.

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

Yes, I would agree with everything that the Greg said and especially through the fourth quarter, but to the extent we do get into a period of stable prices, we should be able to get a bit of a bump in that gross profit margin, even though the fact that we've been able to achieve both getting this environment is still pretty amazing to us. And at the point when we would start to see prices increasing, that's when we should be able to get some type of a spread to our current margins for a period of time.

Anthony B. Rizzuto
Cowen and Company, LLC, Research Division

All right. Excellent, excellent. And then, I wanted to follow up, because we are starting to hear a lot of mixed comments. You guys made mixed comments, Jim talked about obviously some further slowdown, perhaps on ag and industrial equipment. And just my question is on the general health of manufacturing in this country and the industrial economy. Are you guys generally -- can be a little bit more concerned, that with the dollar, with a lot of moving parts here that, that maybe there are some things going on in the underlying economy that are creating some angst among end users?

James D. Hoffman
Executive Vice President of Operations

John, this is Jim. Your guess is as good as mine. I mean, we just -- we see what we see out there. We know energy is down and we think that will continue for a longer period of the time than I would have told you two quarters ago. Ag, mining, the heavy ag, I mean in mining, it's just down, and there is a lot of geopolitical things in the future and in present that are going to keep it that way. But we have got some -- there is -- it's kind of an interesting time, actually the demand other than what I just mentioned is pretty good. If the pricing was anywhere near where it should be with the current demand we have and the current demand we see going forward, not so much in the forward quarter mostly because of the seasonality, we would be in better shape. It's not that we're in good shape now, it's just a matter of the pricing. So, we're okay with the demand.

Gregg J. Mollins
Chief Executive Officer, President and Director

And Tony, we had our semiannual meeting a couple of months ago. And one thing that was consistent at the meeting, there was like 170 of our managers there, was there really wasn't a lot of sniddling if you will about demand, okay, other than the guys in our energy business, they were all at the bar for quite most of the evening, but the demand wasn't really the issue, the issue was pricing. And one thing consistent at that meeting was, if we're not going to be going -- if we're in this environment where prices are dropping so low, okay, we really have to maximize our margin as best we possibly can. And given our model with small order sizes, quick turnaround, high value-added processing, they really put the pedal to the metal because they realize that their sales dollars were going to go down, not necessarily their tons, because demand is reasonable that they had to make it up in gross profit dollars.

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

And I think Tony, that there are comments about some of those specific markets, of course, we're experiencing that to certain extent, that at Reliance, our diversification strategy that we've tried to build company around, we think helps mitigate that offset because we've got positive on markets with growth at the same time that we're experiencing some potential hesitation in the other markets.

Anthony B. Rizzuto
Cowen and Company, LLC, Research Division

I think you guys are obviously doing a lot of the right things and I also like to hear that you guys continue to be disciplined in terms of the M&A front, so that's very good. I think we rather see you buy back stock if your stock is under pressure. But...

Operator

Your next question is from Timna Tanners of Bank of America Merrill Lynch.

Timna Tanners
BofA Merrill Lynch, Research Division

I want to dig in a little bit more maybe along the line for the last question in terms of the volume decline year-over-year, because I think if you asked us a year ago, we would never have anticipated that. So just to understand it, I'm sure some is energy, some is destocking at your customers, some is maybe some other aspects, can you go through and give us like a little more granularity on kind of the broader trend and what contributed to that volume decline?

Gregg J. Mollins
Chief Executive Officer, President and Director

Overall, the volume decline wasn't that bad. Where our tons were down in the third quarter compared to the second quarter only 1.5%, which was frankly a little bit of a surprise to us given the fact that generally third quarter is down somewhere in the neighborhood of 3% to 5% compared to the second quarter. So we felt pretty good about that. So granularity, okay. Automotive and our toll processing is doing well, aerospace is doing well, nonres it's improving, albeit slowly; not as quickly as we would like it to. But we're all up over last year. And our just basic carbon industrial business is doing pretty good. We're still doing strong in the bridge, bridge building, barge, wind tower, transmission tower. Those businesses are all still doing quite well. When you get into the Ag, it gets a lot of press and rightfully so, Deere announcing layoffs and closure of plants at [indiscernible] and all that. So when you get into the large combines and what not, that business is really down a lot, and a lot of -- I think that the Ag manufacturers are from is because of the strong dollar, they are not exporting to the extent that they should. However, when you get into the midsized tractors and industrial lawn equipment and what not, we are doing well in that portion of the Ag business. Mining, that doesn't have to be really we discussed, it's been down at since it's peak in 2011. So lord knows when that's going to come back. But that's been a nonevent for several years now. So...

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

Well Timna, I just want to point out to, it is true that I think we had anticipated some growth this year and we do think some of the markets are growing, but probably more slowly than we have anticipated. But given the pricing environment where we have had prices declining each month, what happens is that at our customer base, they're only buying the minimum quantity. So maybe some of that customer restocking that was built into anticipated volume growth this year hasn't been happening because of the volume, even though the underlying demand is still slowly improving in those areas.

Timna Tanners
BofA Merrill Lynch, Research Division

That was going to be my follow-up, just to clarify. so if you hadn't had falling prices all year, what do you think volumes sort of look like, or if you hadn't had the energy sector crashing, what might have volumes look like?

Gregg J. Mollins
Chief Executive Officer, President and Director

That's a question I'm going to have to put over to Karla.

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

Yes, I mean, it's kind of hard, it's tough to quantify. I mean, your energy was about 10% of our sales dollars, not pounds, but dollars, and their volumes were down over 40% this year compared to last year. So certainly that took away a bit from us. I don't know if you can quantify what demand would be, but what I think we can say is that with the demand levels that exist, which we still think are generally healthy, if that weren't for the imports in the U.S., we think that pricing would be higher, because we think the demand is strong enough to help support pricing absent on the import activity we've seen.

Timna Tanners
BofA Merrill Lynch, Research Division

If I can just ask one more, wanted to understand the timing of the changes in your energy sector exposure and the write-downs there, should we think about this warehouse delivery general administrative decline that you had sequentially as kind of a good run rate going forward, is that all being incorporating as of the third quarter or more cuts kind of going to be reflected going forward?

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

Yes, certainly, in the SG&A line, you really don't see much there from the actual impairment charges. And those are mainly noncash picked up in that impairment line, and there will be a little less amortization expense going forward. Pretax should pick up a bit because of these closures. But SG&A, I mean, we've -- the energy businesses have taken out quite a bit already. There are only a couple of locations that we're planning to close and there aren't significant headcounts there. We have already, I think generally cut expenses, we mentioned down about 30% run rate at our existing energy businesses. So we would expect SG&A on a dollar basis to potentially come down a bit, but not significantly from where we were.

David H. Hannah
Executive Chairman

We'll continue to model as we always do. If continues to get worse, we'll continue to take cost out. And I can tell you that's going to...

Operator

The next question is from Phil Gibbs of KeyBanc Capital Markets.

Philip Ross Gibbs
KeyBanc Capital Markets Inc., Research Division

Great execution. I have a question on the inventory momentum. Are we likely to see more inventory dollar value reductions here in Q4, meaning inventory as a source of cash.

Gregg J. Mollins
Chief Executive Officer, President and Director

Not to the extent that you've seen it in the second and third quarter. So we would hope to have some reduction in our inventory dollars by year-end. But I would not think that it's going to be close to $120 million that we took out in the third quarter.

Philip Ross Gibbs
KeyBanc Capital Markets Inc., Research Division

Okay. I appreciate that. Is there anything on the inventory side where you feel like you're bit heavy or light? I mean, and how does that relate to your end demand outlook potentially for those products, if there are any?

Gregg J. Mollins
Chief Executive Officer, President and Director

Yes. I think really the only area that we're a little heavy on remains the alloy products that are going into energy. Even though we jumped on that in the fourth quarter, very quickly, it's still difficult to lower your inventories when your selling prices are going net down and your volumes are going down, we are down 40% basically in energy. So we still have a little bit more inventory for the energy sector than we would like. We continue to work that down on a daily basis. But really, that's the only area. Our flat-roll inventories in all products are turning well. We had long lead times on aerospace heat treat plate, so -- but that's okay. We do well from profitability point of view on those products. So if we're going to be a little heavy, it would be more on the long lead time items, which really the only long lead time items we have in these companies, the heat-treat plate for aerospace. So we're okay, on inventory. I'm very, very pleased with our position in inventory as we speak.

Philip Ross Gibbs
KeyBanc Capital Markets Inc., Research Division

Okay. And then if I could just kind of piggyback of the Timna's question on the operating expenses. How much of the operating expense reduction in Q3 versus Q4, just specifically talking about SG&A, at least on my numbers, it was down about $13 million, how much of that was core takeout versus lower volumes?

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

I look that it was -- I would say probably core takeout so to speak, I mean, we were into general fluctuations, but there wasn't -- we got the benefit for the full quarter of the majority of the headcount reductions that we took in energy, even though there were some more during Q3, that we got a full quarter's worth of, the majority of those are. But, yes, I don't think there was anything -- any isolated specific items in there.

Operator

The next question is from Matt Murphy of UBS.

Matthew Murphy
UBS Investment Bank, Research Division

Maybe just one more to try and drill down on like real demands during this market, because it's been a sort of common refrain that there is buyer hesitancy and inventories are concerned and so on, just wondering from your just-in-time customers, is there anything you are seeing unusual outside of, sort of normal seasonal trends, I mean, this is a short-term focus question, so like what you're seeing kind of real-time in October, is there anything that different from your just-in-time customers than normal?

Gregg J. Mollins
Chief Executive Officer, President and Director

No. I wouldn't say so. I think third quarter is pretty much panned out on a demand side, much what we anticipated. We kind of missed it on the pricing side because we thought it would be more or less stable to up 1%, and that we had continued to go down. So on the demand with our quick turnaround items for our customers that are buying smaller quantities and needed tomorrow, we haven't seen any surprises, not hearing about any surprises. It's basically kind of business as usual. We're going into the November, December time frame, where we're going to have less billing days, and the holidays seasons and we anticipate that there is going to be, okay, probably more the plant closures in this year's fourth quarter than normal, which is reflected on our guidance, okay. So we are just anticipating that, and hopefully, we're wrong. But you know how we are. We just prepare for the worst and pray for the best.

Matthew Murphy
UBS Investment Bank, Research Division

That's good color. And then I'm just wondering how we should be thinking about your buyback pace. I mean, you slowed down a little bit in the quarter from what you'd announced in July, just wondering if you can share anything about how you think about it in 2016?

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

Yes. I don't think we necessarily slowed down. And again, we're trying to opportunistically repurchase based on the share price and then also our available cash. So I think we were pretty consistent with the way we executed the share repurchases through the quarter. We do think it's a good use of our cash, given the share prices out there. At the same time, we are also committed to trying to pay down some debt, which we were successful and also paying down over $100 million of debt during the quarter. So we are trying to balance both of those, but depending on how the market treats our stock, will depend how active we're in the share repurchases.

Operator

The next question is from Jorge Beristain of Deutsche Bank.

Jorge M. Beristain
Deutsche Bank AG, Research Division

My question was just about your M&A strategy, given that you guys are at about 50% to 60% utilization, the kind of acquisition that you're looking to do, I'm assuming our sort of new product, but is there any kind of internal harvesting that you can do of your existing facilities to repurpose them to target those markets, and would it be a cost savings move to look internally as opposed to doing external M&A?

Gregg J. Mollins
Chief Executive Officer, President and Director

Well, we are always looking at both. And there is that a whole lot of new different types of products that we can get into very honestly. I think we touch on virtually all metal products, and basically every region of the country. So and we look at each acquisition on its own merit. We are not out there looking out for a titanium customer, competitor to acquire rather or anything like that, we'll just look at whatever comes in is profitable and has a great management team. So we really don't have it modeled when we say we want to get into different products. Now there's preferences, okay. Obviously, we'd like to be a little bit more heavy in the like the aluminum plate business in the Southeastern market. But those opportunities they surface when they surface. So it's -- I think we're going to continue our M&A activity in the same manner in which we've been doing since we went even before we went public in '94, and we'll just see how it goes.

William K. Sales
Executive Vice President of Operations

And Jorge, this is Bill Sales. And we are expanding. We've got two new locations of AMI that we opened in Turkey and France. We did the acquisition last year of All Metal Services. Both of those are obviously aerospace related. So we do like some of those end markets, and we look at those acquisitions when they are available to us.

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

Yes, I think also though Jorge, you mentioned, utilization, and that's being at about 50% to 60%, and just as a reminder, utilization at the service center level, we look at much differently than utilization the way the mills look at it. So being at 50% to 60%, kind of a normal capacity rate for us is more about 2/3 or 66% to 67%. So it may not -- we don't think whereas maybe underutilized within our facilities as you might think, if you're thinking about kind of mill targets. So some of our locations, certainly like the ones servicing auto are running higher than that. Some places like our nonres might be below that right now, and we expect that business to come back at some point. But to what Greg said, we do look and we've done some closures recently and some combinations, but we're not probably as far off on utilization from the target as you might think.

James D. Hoffman
Executive Vice President of Operations

And the utilization normally that's weighted on 7 days a week, okay, 24 hours a day. And where we have a few, like our toll processing operations that are servicing auto, appliance and what not, they run those shifts, 7 days a week, 24 hours a day. Our normal service center operates Monday through Friday, okay. Typically it's two shifts running production and one shift doing the loading and what not. That's normal for us. So far a 65% utilization rate during normal to good times is absolutely normal. You don't never hear us say, in my opinion, while not my opinion, period, you will never hear us say that we're at 80% utilization rate, it's just not going to happen.

Jorge M. Beristain
Deutsche Bank AG, Research Division

Got it. Maybe just a follow-up on aluminum as well, because obviously it's the hot topic and everyone is talking about aerospace exposure now. Can you just quantify or explain a little bit better, what exactly you are doing in there by the supplying of the heat-treated plate and stuff? Are you guys doing any further conversion or value adding of that metal cutting, sawing, anything like that? Or you redistributing product mainly from your existing heat-treat plate suppliers?

William K. Sales
Executive Vice President of Operations

No. Most of what we do is processed. The biggest percentage is in aluminum plate, very, very high percent like 90% plus is plate that we will cut. We also do some pre-machining. And we like that value-added business and are continuing to invest and grow in that area.

Jorge M. Beristain
Deutsche Bank AG, Research Division

And does that come with more sort of fixed-price contract that give you visibility or is it more like a cost-plus, so that when you say that you are adding that $300 million revenue, that's just more like a value-add target or could you just explain how the margins for that kind of value-added service look going forward?

William K. Sales
Executive Vice President of Operations

Yes. Most of that is contractual. And so it is more of a fixed-price, where we have our costs fixed and our price to the end customer fixed. And obviously the $300 million is what we're estimating the revenue side of that to be. We still do participate in some of that business as spot business what we call transactional business that would be a customer calling in with an inquiry, we would price it based on that one inquiry.

Jorge M. Beristain
Deutsche Bank AG, Research Division

Got it. And sorry if I could just punch in one last question. I just had a client asking about there was change in your compensation metrics for the executive management, I think previously you targeted about a 13% return on equity, and that was recently lowered to about 10%, any comments on why the change?

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

Yes. I think overall, Jorge, when our board reviewed the compensation, the 13% return on we getting equity metric that has been established as target was based on about a 25-year historical average. And I think, that our board believed that the company was doing a lot of the right things, and where we were performing well at target that 50th percentile that they equate with target within our compensation peer group, but with the 13% target we were not being paid that way. So looking at, kind of updating the average, looking at current market factors, and the way the company has performed, they thought it was appropriate to better align the percentage, which they took down to 10% return on beginning equity to really -- to reflect target performance within our compensation peer group.

Operator

[Operator Instructions] And the next question is from Anthony Rizzuto of Cowen and Company.

Anthony B. Rizzuto
Cowen and Company, LLC, Research Division

Karla, I just had a quick question for you on rough feel for 2016 CapEx at this point, and any commentary you can make on working capital as well as we think about 2016?

Karla R. Lewis
Chief Financial Officer and Senior Executive Vice President

Yes, so I guess, 2016, our CapEx budget, we've been around $200 million on a budget basis the last few years. We've [indiscernible] in this year too, we probably won't hit the $200 million. We will probably spend more in the $170 million to $180 million range. I think we'll still see some good growth opportunities out there. So I would expect in '16 that we would probably be pretty close to where we have been recently, so somewhere around that $180 million to $200 million level. We haven't gone through the process yet. But based on what we see out there, we would anticipate that. From a working capital standpoint, our accounts receivable stays pretty consistent, inventory is the big item there. Quite honestly, we would hope to have to use cash to build working capital, because prices going up and demand going up, everything depends on that. So we certainly would not expect to throw off the cash that we did this year, because as Greg mentioned earlier, our inventories are in much better shape now than they were early this year, which drove part of the strong cash flow. The other element, which is the prices were -- have been declining every month, so that in and up itself throws off cash from working capital reduction. So we would expect a positive cash flow next year, but certainly not -- given steady market -- steady to atmarket conditions, which we're very hopeful for, we would expect it to be much less than in '15.

Operator

The next question is from Phil Gibbs of KeyBanc.

Philip Ross Gibbs
KeyBanc Capital Markets Inc., Research Division

I had a question on the seasonal cadence and demand. I think you outlined 4% to 5% down, and you said normal seasonality is 5% to 10%. Why do you see it better, I guess, relative to what you typically see?

William K. Sales
Executive Vice President of Operations

Well, I think that third quarter, which is normally down 3% to 5%, and it was only down 1.5% for us. That gave us a little bit of guidance that maybe fourth quarter tons are not going to be down as low as the typical years that we've seen over the past 5 years. So that and then also because customers are buying smaller quantities, they need it quicker. The quick turnaround has become even more important to them, because they are watching their inventories because of the pricing going down and what not, that all will bring in business for us probably a little better, because our tons were down 1.5%. MSCI data was down 2.9%, so evidently we're doing something, right. And we attribute it to be the money that we spend on capital equipment. We've got excellent quality that is going out, I think much better than many of our competitors do because they haven't spend the money on newer equipment. So I just think overall, because of the quality that we have, the short turnaround and the smaller quantities, that's which is our sweet spot, I don't think we're going to see as much of a decline in the tons in the fourth quarter as we had seen in other quarters.

Philip Ross Gibbs
KeyBanc Capital Markets Inc., Research Division

That's helpful. Last one and I'll jump off. Jim, I just wanted to clarify something you said earlier, did you say that you saw construction equipment orders from your perspective or demand from metal picking up? I just wanted to be sure I heard that right.

James D. Hoffman
Executive Vice President of Operations

Yes. I did say that. It's enough check, but in a certain segment. Big equipment doing roadwork, planes, that type of work.

Gregg J. Mollins
Chief Executive Officer, President and Director

So basically the heavy equipment, okay, and Ag, we see absolutely no improvement on. We had had a little bit of an uptick when it comes to the midsized tractors, ancillary equipment that are used in that and lawnmowers, industrial mowers for whatever reason, we're actually selling more metal into that segment than we had last year. And I think Kubota announced like a 10% increase in their volumes this year. So we benefited from that. And then certainly the equipment that are going into the industrial areas with respect to supporting highway construction and what not, we benefited in that particular area also. But if you just Ag overall combined, it certainly not doing as well as it did and the forecast are for 2016 to be weaker than they are even this year.

Operator

Thank you. And with that, I'd like to turn the conference back over to Mr. Mollins for any closing comments.

Gregg J. Mollins
Chief Executive Officer, President and Director

Okay. Well, listen, thanks, again, for all your support and for participating in today's call. We would like to remind everyone that in November, we'll be New York City presenting at Cowen and Company 6th Annual Global Metals & Mining Conference and at Barclays Industrial Distribution Forum. We hope to see many of you there. And thanks, again, for joining us, and have a great day.

Operator
Thank you, ladies and gentlemen. This does conclude today's teleconference. You may disconnect your lines at this time, and thank you for your participation.