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RS - Q1 2016 Reliance Steel & Aluminum Co Earnings Call

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OVERVIEW:

RS reported 1Q16 sales of $2.2b and net income attributable to Co. of $92.2m or $1.27 per diluted share. Expects 2Q16 non-GAAP diluted EPS to be $1.15-1.25.

CORPORATE PARTICIPANTS

Brenda Miyamoto *Reliance Steel & Aluminum Co. - IR*

Gregg Mollins *Reliance Steel & Aluminum Co. - President and CEO*

Jim Hoffman *Reliance Steel & Aluminum Co. - SVP, Operations and COO*

Bill Sales *Reliance Steel & Aluminum Co. - ESVP, Operations*

Karla Lewis *Reliance Steel & Aluminum Co. - SEVP and CFO*

CONFERENCE CALL PARTICIPANTS

Tony Rizzuto *Cowen and Company - Analyst*

Phil Gibbs *KeyBanc Capital Markets - Analyst*

Aldo Mazzaferro *Macquarie Research - Analyst*

Jorge Beristain *Deutsche Bank - Analyst*

Timna Tanners *BofA Merrill Lynch - Analyst*

PRESENTATION

Editor

Audio in progress.

Operator

(Operator Instructions) As a reminder, this conference is being recorded.

I would now turn the conference over to Ms. Brenda Miyamoto, Investor Relations for Reliance. Thank you, Ms. Miyamoto. You may now begin.

Brenda Miyamoto - *Reliance Steel & Aluminum Co. - IR*

Thank you, operator. Good morning and thanks to all of you for joining our conference call to discuss our first-quarter 2016 financial results.

I am joined by Gregg Mollins, our President and CEO; Karla Lewis, our Senior Executive Vice President and CFO; Jim Hoffman, our Executive Vice President and COO; and Bill Sales, our Executive Vice President of Operations.

A recording of this call will be posted on the Investors section of our website at (technical difficulty) 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, 2015 under the caption Risk Factors and other reports filed with the Securities and Exchange Commission. The press release and 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 Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

Good morning, everyone, and thank you for joining us today.

We were pleased to see that our positive momentum demonstrated throughout 2015 continued into the first quarter of 2016. Once again, strong operational execution by our managers in the field contributed to FIFO gross profit margin expansion.

During the first quarter, our FIFO gross profit margin reached 29.4%, up 400 basis points from the first quarter of 2015 and marks the fifth consecutive quarter of gross profit margin expansion. Overall, we are extremely proud of this achievement, particularly considering the challenging metal pricing environment that has existed over the past year, coupled with uncertain macroeconomic conditions that have constrained US steel producers. We continue to support these trade actions, which seem to be having a positive impact on reducing the overall level of imports in the United States marketplace and on metal prices. We believe this more positive pricing environment contributed to our expanded gross profit margins to (technical difficulty) as compared to the prior quarter and was still 15.6% lower than the first quarter of 2015.

We expect the price increases will have a more meaningful impact on our average selling price per ton sold in the second quarter as the more recent price increases work their way through the market.

The rising scrap prices we've seen so far this quarter are another positive indicator for pricing.

With respect to customer demand, we experienced a sequential increase in tons sold of 8.9% in the first quarter of 2016, which was slightly better than our expectation of approximately 6% to 8% over the fourth quarter of 2015. The increase reflected both the normal seasonal increase in shipping volumes compared to the fourth quarter, as well as the additional volume from our acquisition of Tubular Steel on January 1. And once again, we outperformed the MSCI industry average increase in tons sold of 6.2% for the first quarter as compared to the fourth quarter of 2015, which reflects Reliance's expanding market share.

On a year-over-year basis, our same-store tons sold were down 3.7% compared to the MSCI industry average decline of 9.1%.

Turning to M&A, as previously announced, effective January 1, 2016, we acquired Tubular Steel, a distributor and processor of carbon alloy and stainless steel pipe, tubing, and bar products based in St. Louis, Missouri.

In addition, on April 1, 2016, we acquired Best Manufacturing, Inc., a custom sheet metal fabricator of steel and aluminum products on both a direct and toll processing basis located in Jonesboro, Arkansas. Best has been serving its core customer markets since 1990, including trucking, agriculture, and energy, and complements Reliance's existing service center network extremely well given its specialty high-margin products and value-added processing capabilities.

Specifically, Best's fabrication business is highly profitable and an area we are looking forward to expanding.

Both of these acquisitions are consistent with our strategy to acquire well-managed metal service centers and processors that provide high levels of value-added processing and specialty products that diversify our existing footprint. We are very pleased to have both Tubular Steel and Best Manufacturing join the Reliance family of companies.

Regarding our capital and allocation priorities, we will continue to support growth through both strategic M&A opportunities and organic initiatives. Our balance sheet remains strong and has enabled us to return capital to (technical difficulty) the Reliance business model in both good times and bad, as well as the continued strong operational execution by our managers in the field. This combination has enabled us to expand our market share, generate strong financial performance, and execute on our growth strategy and stockholder return. (technical difficulty) managing our operating expenses and inventory levels to drive earnings improvement and balancing our capital allocation priorities allowing for growth and continued stockholder returns.

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

Jim Hoffman - *Reliance Steel & Aluminum Co. - SVP, Operations and COO*

Thanks, Gregg, and good morning, everyone. My comments today will focus both on pricing and demand of our carbon steel and alloyed products, as well as our outlook on certain key end markets we sell those products into, including automotive, heavy industry, nonresidential construction, and energy. Bill will then address our aluminum and stainless steel products and related end markets.

Before turning to our markets and pricing, I would like to say how proud I am of our employees in the field that helped us increase our FIFO gross profit margins in the first quarter of 2016 by 270 basis points over the fourth quarter of 2015. Unbelievable! I am equally proud of our inventory turns of 4.9 times based on tons, which exceeds our Companywide goal of 4.7 times.

Demand for automotive, which we service mainly through our toll processing operations in the US and Mexico, remains strong in the first quarter. The construction of our new facility in Mexico, which will aid in increasing our existing toll processing capability, is nearing completion and is expected to become operational in mid-2016. Given increased activity processing aluminum for the automotive industry, we're also constructing a new facility in Kentucky and expanding two of our existing facilities. We continued to perform very well (technical difficulty) of the metal. And although our toll processing represents a small portion of our total sales dollars, it represents a larger percentage of our overall profitability.

First-quarter demand in heavy industry, which includes rail car, truck trailer, shipbuilding, barge manufacturing, (technical difficulty) in the road construction equipment market in 2016. Demand in nonresidential construction is continuing its slow but steady improvement, despite volume being well below peak levels. We are optimistic that demand will continue to improve in 2016 and beyond although at a gradual pace.

Given our outlook for this market, we've been strategically investing in processing equipment over time to position ourselves to absorb volume increases and our existing cost structure, as well as to perform additional value-added processing for our customers as this market improves.

In regard to (technical difficulty) to be proactive in managing our expenses to help mitigate the negative impact to our overall profitability.

Turning to pricing, as Gregg discussed, we are finally starting to experience a pricing improvement for carbon steel products during the first quarter, mainly as a result of increases in raw material costs, including scrap and multiple carbon steel trade cases filed in the US. We expect to see a greater benefit from the increased carbon steel prices in the second quarter, which should allow us to increase our average selling price over the first-quarter levels. (technical difficulty) impacted by pricing on these products versus carbon flat-rolled products, which represents only 15% of our total sales with hot-rolled at 6%. Flat-rolled pricing also began to recover during the first quarter with multiple price increases announced by the mills in 2016 after having been under pressure for the entire 2015 year.

It's important to note that although we are experiencing pricing recovery and extended leadtimes, our suppliers have not yet announced capacity increases. We applaud our domestic suppliers on their production discipline.

Base prices for alloy products, the majority of which are sold into our energy end markets, has held up well considering the significant reduction in demand. Going forward, we expect prices for these products to remain fairly steady with current levels due in large part to alloyed products going into the automotive market.

I will now hand the call over to Bill to comment further on our nonferrous markets. Bill?

Bill Sales - *Reliance Steel & Aluminum Co. - ESVP, Operations*

Thanks, Jim. Good morning, everyone. Before talking about the markets, I would like to note that demand for our aluminum and stainless steel products continued to be good through the first quarter of 2016. Our managers have done an excellent job managing gross profit margins through the quarter, and we are very pleased with their results. To all from that group listening to the call, keep up the good work.

Now on the specific markets, aerospace continues to be one of our strongest end markets. Sales to the aerospace market represented approximately 11% of our total sales in the first quarter of 2016. Our same-store tons sold to the aerospace market were up 5.3% compared to the first quarter of 2015.

Demand in this market continues to be steady. Build rates for some of the larger commercial planes have been reduced but still remain at healthy levels. These build rate reductions tend to impact demand at the mill level more than service centers. The backlog for orders of commercial planes remains robust, and mill leadtimes are extended. As a result, our outlook remains positive, and we will continue to look for investment opportunities to expand our aerospace exposure consistent with our customers' growth patterns.

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 continued steady demand, we expect pricing for aluminum aerospace plate to be relatively stable with modest pressure on margins for the balance of the year.

Since we spoke last with you in February, our sales of common alloy aluminum have increased somewhat from a volume standpoint with most of our product being sold to sheet metal fabricators that support a variety of end markets. Demand for general engineering aluminum plate is strong, driven by general industrial and semiconductor end uses. We still anticipate a challenging price environment due to aggressive import pricing.

Pricing on common alloy aluminum sheet follows [ingot], and we expect some modest improvement as the Midwest spot price trends up slightly. The Midwest spot price has been trading in the $0.79 per pound range with the Midwest premium in the $0.08 per pound range.

Turning to stainless steel products, demand for our stainless steel flat products, which are primarily sold into the kitchen equipment, appliance, and construction end market continues to be strong. Both price increases in the first quarter of 2016 are in place, and domestic mill leadtimes have extended to nine to 14 weeks. The third increase announced last week for May shipments has domestic mill support.

Pricing for stainless steel products is heavily impacted by nickel prices, which continued to decline in the first quarter of 2016. We expect to see some modest improvement in nickel pricing in the second quarter of 2016.

I will now turn the call over to Karla to review our first-quarter financial results.

Karla Lewis - *Reliance Steel & Aluminum Co. - SEVP and CFO*

Thanks, Bill, and good morning, everyone. Our sales in the first quarter of 2016 were $2.2 billion, down $451.7 million or 17.3% from the first quarter of 2015, mainly due to lower metals pricing.

Compared to the fourth quarter of 2015, our sales were up $136.5 million or 6.7% due to normal seasonal trends of increased shipments, along with the incremental sales from our January 1 acquisition of Tubular Steel. Our average selling price decreased by 2.4% compared to the fourth quarter of 2015 and by 15.6% compared to the first quarter of 2015.

We had expected our average selling price for tons sold to be flat to up 1.5% from the fourth quarter of 2015 given mill price increases. However, as Gregg mentioned, the price increases were not immediately absorbed by the market and the majority of the increases occurred late in the quarter. Our average inventory costs declined during the first quarter of 2016, resulting in a lower average selling price even as we increased our gross profit margins.

We did not record a LIFO inventory valuation adjustment for the first quarter of 2016. Based on current metals priced trends, we expect overall metal prices to be higher at December 31, 2016 as compared to January 1, which would result in a LIFO charge or expense in 2016. However, given our current expectation of higher metal prices, we anticipate that any LIFO expense would be offset by a decrease in our lower cost or market reserve, established as of December 31, 2015. We will continue to update our expectations quarterly based upon our inventory costs and general metals pricing trends.

Our gross profit margin of 29.4% in the first quarter of 2016 increased from 25.7% in the first quarter of 2015 and from 28.7% in the fourth quarter of 2015 due to the pricing discipline of our employees in the field. Our average selling price declined less than our inventory costs declined as we continued to receive in lower cost materials during the beginning of the first quarter. Our continued growth in higher-margin specialty products and value-added processing, along with our focus on superior customer service, also contributed to continued sequential improvements in our gross profit margin.

Our SG&A expenses in the first quarter of 2016 included the expenses of tubular steel. On a same-store basis, our SG&A expenses decreased by $4.6 million from the first quarter of 2015. As a percent of sales, our SG&A expenses were 20.8% compared to 17.1% in the first quarter of 2015, yet below 6.5% in the first quarter of 2015, again, mainly due to lower metal prices.

Our effective income tax rate for the first quarter of 2016 was 14.4% compared to 31.7% in the first quarter of 2015 and 27.1% (technical difficulty) income tax rate at approximately 27%, down from 31.1% in 2015. Net income attributable to Reliance for the first quarter of 2016 was $92.2 million or $1.27 per diluted share compared to $101.3 million or $1.30 per diluted share in the first quarter of 2015 and $68.6 million or $0.94 per diluted share in the fourth quarter of 2015.

On a GAAP basis, our net income included a $17.6 million or $0.24 per diluted share favorable impact due to the lower tax rate. As such, our non-GAAP net income attributable (technical difficulty) and $63.3 million or $0.87 per diluted share in the fourth quarter of 2015. Our earnings release issued earlier today includes a reconciliation of our non-GAAP adjustments.

Turning to our balance sheet and cash flow, we generated $155.4 million of cash from operations (technical difficulty) sales outstanding rate at March 31, 2016 of 42.3 days, in line with our historical range. Our inventory turn rate at March 31 was 3.9 times based on dollars and 4.9 times -- 2.4 months on hand based on tons. Our focus on inventory reductions in 2015 resulted in successfully exceeding our Companywide goal of 4.7 turns based on tons. At March 31, 2016, our total debt expanding was $2.13 billion, an increase of $205.4 million from December 31 as we funded our purchase of Tubular Steel with borrowings on our revolving credit facility. Our net debt to total capital ratio was 33.4%, and our net debt to EBITDA ratio was 2.6 times. As of March 31, 2016, we had $887.1 million available on our $1.5 billion revolving credit facility.

We will continue to execute on our capital allocation strategies of both growing the business and returning value to our stockholders while also using available cash to continue reducing our outstanding debt balance.

In addition to the two acquisitions we've completed so far in 2016, we spent $34.4 million on capital expenditures during the first quarter. Our 2016 CapEx budget of $180 million is focused primarily on organic growth, specifically through purchasing new equipment to increase our value-added processing capabilities and opening new facilities.

In the first quarter of 2016, we paid quarterly cash dividends totaling $29 million. We did not repurchase any shares of our (technical difficulty) in the quarter, mainly because of our improved stock price. We will, however, continue to monitor our stock price performance and cash availability and will opportunistically repurchase shares as appropriate.

Now turning to our outlook, we are optimistic about metal pricing in the second quarter of 2016, given recent mill price increases and are confident in our ability to execute well in this environment. We also expect continued slow growth of the US economy. As a result, we estimate tons sold to be flat to up 2% in the second quarter of 2016 compared to the first quarter of 2016, and we expect our average selling price per ton sold in the second quarter of 2016 to be up approximately 3% to 5% from the first quarter. As a result, we currently expect non-GAAP earnings per diluted share to be in the range of $1.15 to $1.25 for the second quarter of 2016, up from $1.03 non-GAAP earnings per diluted share in the first quarter of 2016.

In closing, we are very pleased with our strong start to the year, which is reflective of our proven abilities to manage the controllable aspect of our business. We congratulate our managers in the field for their hard work as their operational execution contributed to our fifth consecutive quarter of increased FIFO gross profit margins. This improvement, coupled with our effective working capital management, has helped our cash generation remain strong, enabling us to continue to grow and diversify.

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?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Tony Rizzuto, Cowen and Company.

Tony Rizzuto - *Cowen and Company - Analyst*

I guess my first question is just to pursue a little bit on the operational execution, it was clearly phenomenal, 29.4%, and I'm wondering how much further juice can you squeeze from that going forward?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

Wow, that's a tough question. If you would have told all of the management team here that we were at 29.4% first quarter about 90 days ago, we probably would have thought you were crazy. But our guys in the field -- there's been a big push from our VP of Operations, Bill, Jim, Steve, Mike, on gross profit margin over the past 16 to 18 months, and fortunately our guys in the field have listened and executed. So as far as going up over 29.4%, I really couldn't say that that's probably a good model to (technical difficulty).

Karla Lewis - *Reliance Steel & Aluminum Co. - SEVP and CFO*

-- maintain at least (technical difficulty)

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

Yes. Exactly. So it was a great run. And hopefully we can maintain that, but I wouldn't completely count on it. And I hope anybody that is listening to our call from the Reliance team ignores everything I just said.

Tony Rizzuto - *Cowen and Company - Analyst*

(technical difficulty) performing the industry, the MSCI data. And just looking at the breakout between alloy and carbon, etc. and aluminum and stainless, is the majority of that year-on-year decline on a same-store basis -- would the majority of that be related to energy?

Karla Lewis - *Reliance Steel & Aluminum Co. - SEVP and CFO*

I don't -- certainly a good chunk of that, Tony, would be energy-related, and then you would just see I think in some of the heavier carbon products, you might see a little bit of a downturn there, but it definitely is impacted by the reduction in energy.

Tony Rizzuto - *Cowen and Company - Analyst*

So we've seen a -- I don't know, about 60%, 70% increase in oil prices, but rig activity continues to contract. Are there any reasons or -- any reason to be hopeful a little bit as you see things? Our inventory is just so heavy out there that just no room for improvement maybe this year?

Jim Hoffman - *Reliance Steel & Aluminum Co. - SVP, Operations and COO*

Hey, Tony. This is Jim. Not really. We say that we don't use hope as a strategy around here. We kind of just manage what we are dealing with, and there's really nothing that looks great on the horizon. However, when it does come back, and it will, eventually we will be there to service our customers because there's really nothing right now that I can (technical difficulty)

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

We are not counting on any improvement really, Tony, in 2016 period.

Tony Rizzuto - *Cowen and Company - Analyst*

Okay and I'm just -- I'm wondering just on the toll processing because I'm -- you guys are doing a lot of great things there, and you talked about construction of a new facility in Mexico, it's nearing completion. You are expanding some facilities in (technical difficulty) equivalent in terms of overall profitability, and maybe with these expansions from a volumetric standpoint, if you could frame it in terms of X percent over what you currently have in place, just to help us understand what that may be and how you are looking at the business in terms of its ability to increase your profitability, and what is the high-margin product for you?

Karla Lewis - *Reliance Steel & Aluminum Co. - SEVP and CFO*

Yes, Tony, we are pretty hesitant to give too much detail on individual parts of our business. So -- and I know you guys would love to hear more details on that, but certainly the profitability, as we have said, is meaningful to us. So certainly that the growth there will have a positive impact on our earnings as we move forward.

As far as quantifying that, that is not something that we are really going to do. The aluminum -- the increase in processing, a lot of that has been in aluminum. Mexico is not geared towards that, but we have seen quite an uptick, which kind of moved us -- helped moved us from that 2% of total sales dollars to 3% of total sales dollars last year, and we expect to see continued processing. But we are still processing. The majority of our tons are still carbon times that we are running through there. So the increased aluminum is meaningful, but it's incremental increase.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

I think it's important to realize, too, is the comment that Karla just made is that we really haven't seen any decline whatsoever on our carbon side of our toll processing operations. So it's not -- we have not seen -- I'm not saying it's not going to happen, but we have not seen a displacement of carbon steel because of the expansion into aluminum. And that is -- I think that's important for everybody to realize.

Tony Rizzuto - *Cowen and Company - Analyst*

Okay. And I guess as a good segue, talking about aluminum and steel together, I would be remiss if I didn't ask you about -- and get Bill involved here, too, about the Section 201 -- the petition by the United Steel Workers on the aluminum side, and just your general thoughts -- the industry in terms of the steel mill executives have been very confident about the trade legislation going through. But then at the same time, we are hearing more vocal commentary about the Section 201, and I just wonder how you see this? Obviously your major buyers from all these players, the mills, and I'm just wondering from your vantage point, how you are sizing this up and how you think this can play out, and is 201 necessary to ensure these gains that have been made thus far?

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Bill Sales - *Reliance Steel & Aluminum Co. - ESVP, Operations*

Hey, Tony. It's Bill. How are you doing? We look at that -- I think we are seeing if you look at the Midwest premium or the Midwest spot price, we've seen some improvement this morning. I think it's it [82] plus. And I think that -- from what we are hearing, a lot of that is driven by the anticipation of the 201 case. I think if you look at the levels where we've seen the Midwest spot price, it's been at levels that are very difficult for a lot of the producers to be profitable. And I think that is what is driving this whole action.

But in terms of understanding all of the details around it and the logic behind it, we haven't really gone through (technical difficulty) that the ramp up now, we may see that back off some, too. So we just watching it closely.

Tony Rizzuto - *Cowen and Company - Analyst*

I guess, Gregg, you mentioned that you were -- so far, you were very pleased with the discipline on the part of the integrated mills, and it seems to me that that is going to be critical going forward in this whole (technical difficulty)

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

I just -- I think the mills are being driven more by profitability than volume. Their production is going up. I think it's over 70%, maybe 71% of production capacity, which is above like 62% in January. So -- but they are not ramping up, they are not starting up the facilities that they've shut down in the past. So, at the end of the day, I think that the mills are going to continue their discipline actions and keep their prices up.

Tony Rizzuto - *Cowen and Company - Analyst*

Thanks very much. I appreciate all the comments. Thank you.

Operator

Phil Gibbs, KeyBanc Capital Markets.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

I had a question for Bill just on the comments on the aluminum side. Did you say the pricing momentum in the aerospace plate is moderating, or is that still moving higher? I might have not caught all that.

Bill Sales - *Reliance Steel & Aluminum Co. - ESVP, Operations*

Yes, Phil. It's basically pricing. We look at it, we think pricing is going to be stable with some modest pressure on margins. If you look at the date, mill leadtimes are still extended. They are a little bit shorter than they were a quarter ago, and plate, while it is still relatively tight, it's a little less tight than it was a quarter ago. So I think our outlook right now -- it's a still very positive environment, and I think pricing is going to be stable. But there will be a little more pressure on the margin side.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Okay. I appreciate that, and Jim, what is your broader outlook for heavy equipment based on what you're seeing right now?

Jim Hoffman - *Reliance Steel & Aluminum Co. - SVP, Operations and COO*

I would say it is flat but at a decent level. Demand is really not a problem for us right now. It's always been the price, and the price is moving up. So we are good with the demand we are seeing, and I just -- it will be the same way throughout 2016.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Great. And just one quick one on the import offers in general, Gregg. What are you seeing there in terms of the import offers across your varying degrees of products? Just your big buckets, carbon, aluminum, and stainless, and how competitive or lack thereof the foreign mills are being at this time. Thanks.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

I will let Bill address the stainless and aluminum outlook, but on the carbon side, Jim and I actually were having a conversation with a few of our guys in the field earlier this morning and offerings that we are getting on basically all the carbon side whether it be structural or flat-rolled, etc. are (technical difficulty) are very few and far between as compared to even six months ago.

Bill Sales - *Reliance Steel & Aluminum Co. - ESVP, Operations*

Yes, Phil. On the aluminum side, on general engineering plate, we are seeing still aggressive import pricing. And so that is one area where there still is a fairly significant gap between the domestic price and the import, but there is still a fairly strong requirement for domestic plates.

So I think the domestic mills are (technical difficulty) of the common alloy market. Stainless, we are probably seeing a little increase in the spread between domestic and import with these price increases on the stainless side, but that spread is still in a reasonable area, and we feel very positive about the May increase. It seems to have domestic mill support, and I think it will have support in the marketplace.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Thanks for all the insight, guys. Appreciate it.

Operator

Aldo Mazzaferro, Macquarie.

Aldo Mazzaferro - *Macquarie Research - Analyst*

Say, a couple of my questions get answered already, but on the import question you just answered on the carbon steel imports that you are seeing few and far between, can you say whether there is any new sources of imports that you might be seeing or we haven't seen in the last few years? By country I mean you know? The --

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Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

I would say not recent, but in the last year and a half, we've seen Japan more involved in the carbon steel plate arena than we have probably in the last 15 years before that. Russian -- what are we seeing on the Russian side, Bill?

Bill Sales - *Reliance Steel & Aluminum Co. - ESVP, Operations*

Russian seems to be coming -- recently -- I can tell you one thing, there's a lot less Chinese offers right now.

Aldo Mazzaferro - *Macquarie Research - Analyst*

Is that Russian on -- that Russian is carbon plate also?

Bill Sales - *Reliance Steel & Aluminum Co. - ESVP, Operations*

Yes.

Aldo Mazzaferro - *Macquarie Research - Analyst*

And on the flat-rolled side, you're not seeing anything to replace the Chinese or the --

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Bill Sales - *Reliance Steel & Aluminum Co. - ESVP, Operations*

Other countries, career, Vietnam, Italy, it's the same as it has been, but the significant impact right now is there is less Chinese offers. Gregg mentioned Japan. They have been out of the game for it seems like years. But then last year they started coming back in and the officer there and they are still there. But they are -- it's the usual suspects.

Aldo Mazzaferro - *Macquarie Research - Analyst*

Great. Okay. And just one follow-up, Gregg. I am trying to figure out how your gross profit margins would not expand in the second quarter. If I'm reading it right, you've got -- you are going to get a little price -- a little higher price, but you had a 2% or so lower price in the first quarter versus the fourth, and I'm just wondering, do you think the mills are going to actually squeeze you on the upside, that they will get their costs up to you, or your mill costs will be greater than 3% to 5% higher?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

I don't really think it has anything to do with the mills. It is just the customer base. When you have a 270 basis point increase in one particular quarter, I think that's -- I've never seen that happen in our Company, and I've been with Reliance over 30 years. So to feel as though you can get an additional increase over that 270 basis points I think is a little bit optimistic.

Karla Lewis - *Reliance Steel & Aluminum Co. - SEVP and CFO*

And, as you know, we are always conservative and kind of the base cost, so to speak, of the metal has been fairly low. Our average sales price in Q1 trended down a bit because our average inventory costs trended down even more. So we think our gross profit margin, our percent might see a little pressure. We would generate more gross profit dollars if we had higher selling prices, which would fall to the bottom line. So even if there is a little squeeze on the margin, if we have higher selling prices, that is positive. And we've also talked about the increase in value-added processing that we are doing at Reliance now because of a lot of the investments and things that we've made, and our charge, so to speak, for the value add doesn't fluctuate with metal prices. So if metal prices go up, that processing portion of the charge of the price becomes a little less. So that's why we're just a little hesitant on the guidance on the gross profit margin that you could see a little impact from the higher metal costs.

Aldo Mazzaferro - *Macquarie Research - Analyst*

Great. Great job in this quarter, anyway, I have to say. Appreciate it.

Operator

Jorge Beristain, Deutsche Bank.

Jorge Beristain - *Deutsche Bank - Analyst*

I was just wondering if you could point to what specific metal lead you to have your below guidance quarter over quarter reduction in price? Was it aluminum? Was it carbon steel? What was it that really led to that kind of quote-unquote (technical difficulty)

Karla Lewis - *Reliance Steel & Aluminum Co. - SEVP and CFO*

-- the momentum at the end of the fourth quarter, beginning of the first quarter, I think based on that, we felt we were going to get a higher sale price. At the same time, there were more price increases, especially for carbon, during the first quarter than we had anticipated. It just didn't run (technical difficulty)

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

-- or sales dollars, beg your pardon. Much more on the tons side. But -- so that's really what moves the needle for the most part would be carbon. So I would have to agree with Karla there that, as goes carbon, as goes our volume and our margin.

Jorge Beristain - *Deutsche Bank - Analyst*

Okay. Thank you. And just to drill down what do you think is happening psychologically in the market with your customers who seem to be kind of, as all of us I'm sure, caught like deer in the headlights with just rapid increase in at least HRC prices, but is that motivating any change in customer behavior where you are now getting people to start scrambling a little bit to put in orders that maybe they were thinking of deferring? Can you just talk to a little bit of the psychology, or are people sitting here and watching this price hike and just taking it in stride and seeing how it's going to play out ultimately?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

You have to realize that you know our average order size is from about $1600, so we are dealing with a lot of small to midsize job shops here. That is probably the vast majority of our businesses is not with large OEMs. And so, therefore, they are really not buying in advance. We have not seen or heard from our guys in the field that anybody is building inventory in anticipation of higher prices. So I would have to say basically it is business as usual with our customer base, and we don't see anybody really trying to build inventories ahead of price increases.

Bill Sales - *Reliance Steel & Aluminum Co. - ESVP, Operations*

Jorge, we spent a lot of money over the last five years on value-added capacities, and I think psychologically and realistically, when you go through times like this, our customer base, they don't expand their value-added or internal equipment as much as they have. So they look to us to do more processing, and that's a good thing. We anticipated that, and we will continue to spend money along those lines so we can offer more things to our customers.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

We think that was the biggest driver of our margin improvement. It was in growth-orientated initiatives. We are pushing processing throughout the globe actually, but in particular in North America, and it is yielding us higher margins.

Jorge Beristain - *Deutsche Bank - Analyst*

Great. Thank you.

Operator

Timna Tanners, Bank of America Merrill Lynch.

Timna Tanners - *BofA Merrill Lynch - Analyst*

I wanted to ask (technical difficulty) acquisitions and expanding into value-added and processing. So I'm just wondering if you could characterize the M&A environment now and if you anticipate running against them in bigger endeavors?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

We really haven't run into any competition from the mill level on any of our M&A activities. I would imagine there -- everybody is trying to get into value-added, I would guess, but them coming into our space, we have not seen that and, frankly, don't anticipate that to happen.

Timna Tanners - *BofA Merrill Lynch - Analyst*

Okay. Cool. Thanks. And then, Karla, can you elaborate -- I didn't follow -- I'm not sure I followed what you mentioned about buyback plans and you had expanded your buyback program but then commented on not having bottom in the last quarter. Can you just elaborate on that again, please?

Karla Lewis - *Reliance Steel & Aluminum Co. - SEVP and CFO*

Yes, in the first quarter of 2016, we were not in the market, and we didn't repurchase any of our shares. Mainly because of where the share price was, we saw the improvement in the first quarter, although certainly there's still room to go. But we opportunistically repurchase based upon the -- our stock price and our cash availability and just chose not to repurchase during the first quarter.

Timna Tanners - *BofA Merrill Lynch - Analyst*

Okay. Got it. Thanks very much.

Operator

Thank you. At this time, I would like to turn the conference back over to Mr. Mollins for any closing remarks.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President and CEO*

Okay. Well, listen, thank you very much for your support and for participating in today's call. We want to thank you very much for that, and just wishing all of you a great day. Thanks for being with us this morning.

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.
