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RS - Q2 2016 Reliance Steel & Aluminum Co Earnings Call

EVENT DATE/TIME: JULY 21, 2016 / 3:00PM GMT

OVERVIEW:

Co. reported 2Q16 sales of $2.2b and net income attributable to Co. of $100.9m or $1.38 per diluted share. Expects 3Q16 non-GAAP diluted EPS to be $1.25-1.35.

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PRESENTATION

Operator

Greetings and welcome to the Reliance Steel & Aluminum Co. second-quarter 2016 earnings conference call. (Operator Instructions). As a reminder this conference is being recorded. I would now like to turn the conference over to your host, Miss Brenda Miyamoto, Investor Relations for Reliance. Thank you. Please go ahead.

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 second-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 investor.rsac.com. The press release and the information on this call may contain 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, 2015 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 Mollins - *Reliance Steel & Aluminum Co. - President & CEO*

Good morning, everyone, and thank you for joining us today. I would like to start off by saying that I am extremely proud of the outstanding execution by our managers in the field which contributed to our sixth consecutive quarter of FIFO gross profit margin expansion.

Over the past few years we have made significant investments in cutting edge value added processing equipment to provide higher value to our customers which has benefited our gross profit margin. And, as we have discussed in previous quarters, in 2015 we focused our efforts on reducing our inventory levels resulting in a $433 million reduction in inventory.

In addition to improving our inventory turn and working capital management, we believe our improved inventory position has also contributed to our increased gross profit margin by allowing us to be more selective in our efforts by focusing on higher margin business.

During the second quarter our gross profit margin further benefited from a rising pricing environment, most notably for carbon steel products. We were able to enhance our gross profit margin as we pushed through more price increases in the marketplace. As a result of all these factors, our second-quarter FIFO gross profit margin reached 31.1%, up 540 basis points from the second quarter of 2015.

The metals pricing environment continued to improve as the second quarter progressed with multiple price increases announced on certain carbon steel products. The mill price increases were supported by many factors including steel demand and the filing of multiple trade cases by US producers that have reduced import offerings.

In addition, the domestic producers have maintained production capacity discipline and raw material costs have increased. Despite these positive factors, however, the overall pricing environment remains below 2015 levels and far below peak levels. Our average selling price per ton sold during the second quarter of 2016 was 10.1% lower than in the second quarter of 2015.

In regard to customer demand, we experienced a sequential increase in tons sold of 1.1% in the second quarter of 2016 which was in line with our expectation of flat to up 2%. Although end demand is not as strong overall as we had anticipated going into 2016, we believe demand is generally healthy with certain markets such as automotive and aerospace continuing to perform at high levels.

Our strategy of diversifying our product and end market exposures, along with our ongoing investments in state-of-the-art value added processing equipment and our relentless focus on customer service, has allowed us to increase our market share. For the first six months of 2016 we once again outperformed the industry with our same-store tons sold down only 2.1% versus the MSCI industry average shipments which were down 6.9% as compared to the first six months of 2015.

Turning to M&A, we have completed two acquisitions so far in 2016. 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. Best is a great company and has been performing above our expectations since joining the Reliance family.

Tubular Steel, which we acquired at the beginning of the year, is also performing well given its end market exposures. Both of these acquisitions meet our criteria of acquiring well run businesses that are immediately accretive to earnings. Given the specialty products or high value added services provided by these companies, they perform above our companywide profitability levels.

Strategic M&A opportunity and organic investments will both continue to be integral growth drivers of Reliance. Our balance sheet is strong because our managers have done a great job expanding our margins and rightsizing our inventory levels.

Together these actions have produced high levels of cash flow enabling us to execute on our balanced capital allocation strategy, allowing for growth of the business as well as stockholder returns including our 6.3% dividend increase effective for the third quarter of 2016. We have paid regular quarterly cash dividends for 57 consecutive years and increased our dividend 23 times since our IPO in 1994.

In summary, I believe our execution in the first half of the year has been outstanding. Our strong financial performance is the result of margin expansion, due in part to favorable pricing environment, as well as diligent expense and inventory management to drive improved profitability. Going forward we will continue executing our strategy with the goal of extending our track record of delivering industry leading results.

Reliance wouldn't be the Company it is today without the incredibly talented team that we have in place. On that note this month marks Dave Hannah's official retirement as Reliance's Executive Chairman as part of the executive leadership succession plan we announced in May of 2015. Dave will continue as a member of Reliance's Board of Directors. We thank Dave for his leadership and many contributions over his 35 year career at Reliance. We all wish Dave the very best in his retirement.

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

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

Thanks, Gregg, and good morning, everyone. First, along with Gregg's comments earlier, I would like to thank our operators for their tremendous efforts in achieving a 31.1% gross profit margin in the second quarter of 2016. To all of you listening in on the call, congratulations and keep up the good work.

Now I will comment on both pricing and demand for our carbon steel and alloy products as well as our outlook on certain key end markets we sell those products into. Bill with then address our aluminum and stainless steel products and related end markets.

Demand for automotive, which we service mainly through our toll processing operations in the US and Mexico, remained robust throughout the second quarter. In addition to strong carbon steel demand, we are continuing to see increased demand for aluminum processing in the automotive industry.

We recently opened a new facility in Mexico to support the increased automotive activity in that area. We also added a second line to process aluminum for the automotive industry in our Michigan facility in the second quarter of 2016 and we will be opening a new facility in Kentucky in 2017 to support both aluminum and steel processing in that area.

These investments provide us with additional capacity to service this important end market and processing carbon steel, as well as aluminum, where volumes are increasing at a rapid rate. We are very well positioned from both a technology and capital perspective to continue to support this growth.

As a reminder, while only a small percentage of our total sales dollars, our toll processing activities represent a far greater proportion of our total overall profitability.

Second-quarter demand in heavy industry, which includes rail car, truck trailer, shipbuilding, barge manufacturing, tank manufacturing and wind and transmission towers, remained flat to slightly down from the first quarter of 2016 levels. Our exposure to heavy equipment also includes sales to agriculture equipment OEMs which have been weak for the larger ag equipment.

That said, Reliance's exposure is mostly to small and midsize agriculture equipment which has held up better than the heavier items. We are hopeful that the five-year infrastructure bill that was passed on December 2015 will improve further demand trends in the infrastructure and road construction equipment markets beginning 2017.

Demand in nonresidential construction continues its gradual but steady improvement and we are seeing increased activity in these markets we serve with our tons shipped slowly improving. Despite volumes being well below peak levels, we believe that demand will slowly continue to improve in 2017.

We have made investments in processing equipment for many of our businesses that support this market in order to provide higher levels of processing to our customers. Increased volumes will be absorbed into our existing cost structure as this end market continues to improve.

Demand for energy, which is mainly oil and natural gas, has fallen further in the second quarter of 2016 from already weak levels due to continued reduction in drilling activities. We have been, and continue to be, proactive in reacting to these market conditions and managing our expenses accordingly. Although our outlook for energy remains weak in the near-term, we have begun to see early signs of new activity in this end market.

Although pricing for carbon steel products remains well below peak levels, prices continued to improve throughout the second quarter, primarily due to increases in raw material cost, including scrap, and multiple carbon steel trade cases filed in the US that have resulted in reduced import offerings. The most significant price increases were for carbon steel flat rolled products, which represent only about 15% of our total sales with multiple price increases announced by the mills in the first half of the year.

Carbon steel plate and structurals represent the single largest components of our product mix with each accounting for 10% of our total sales. Tape volumes have been down in 2016 mainly because of the weakness in heavy equipment. However, prices have increased in both quarters of 2016. Demand for carbon steel structurals has increased in 2016 mainly due to the steady improvement in nonresidential construction.

Base prices for alloy products, the majority of which are sold into our energy end markets, have declined, although they have held up better than we expected considering the significant reduction in demand. I will now hand the call over to Bill to comment further on our nonferrous markets. Bill?

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

Thanks, Jim. Good morning, everyone. Today I will discuss pricing and demand for our aluminum and stainless steel products and certain markets we sell those products into. But before I begin I would also like to recognize our managers for their excellent execution in the second quarter. Keep up the great work.

Demand for our aluminum and stainless steel products continued to improve in the second quarter of 2016. Aerospace continues to be one of our strongest end markets. Sales to the aerospace market represented approximately 11% of our total sales in the second quarter of 2016. Our tons sold to the aerospace market were up 2.9% compared to the first quarter of 2016 and up 4.4% compared to the second quarter of 2015.

Demand in aerospace continues to be strong for the products we sell. However, we expect the growth rate to moderate slightly as build rates for certain aircraft decline and mill lead times compress a bit.

Our investments in new international markets have expanded our presence and the global market allowing us to support our customers as they expand. The backlog for orders of commercial planes remains robust. As a result our outlook remains positive and we will continue to look for investment opportunities to expand our aerospace exposure.

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. Since we last spoke with you in April, our sales of aerospace aluminum plate and general engineering aluminum plate have increased and volumes continue to be strong despite some pressure on pricing.

In terms of our outlook for the balance of the year, we expect continued steady demand with some pressure on margins for both aerospace and general engineering aluminum plate. Common alloy aluminum pricing has remained stable and volume has increased modestly with most of the products being sold to sheet metal fabricators that support a variety of end markets.

Pricing on common alloy 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 $0.82 per pound range with the Midwest premium in the $0.07 per pound range which was fairly steady compared to the first quarter of 2016.

Turning to stainless steel products, demand for our stainless steel flat products, which are primarily sold into the kitchen equipment, appliance and construction end markets, continue to be very strong. Domestic mill lead times have extended to 8 to 10 weeks and we believe there is room for a potential base price increase in the back half of the year.

Pricing for stainless steel products is heavily impacted by nickel prices, which have been improving modestly on a sequential quarter basis. We expect to continue to see some improvement in nickel pricing in the back half of the year. I will now turn the call over to Karla to review our second-quarter financial results. Karla?

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Thanks, Bill, and good morning, everyone. Our sales in the second quarter of 2016 were $2.2 billion, down $219.8 million or 9.1% from the second quarter of 2015 due to lower metal prices with our average selling price for tons sold down 10.1%. Demand was relatively consistent with our same-store tons sold down 0.4% year over year.

Compared to the first quarter of 2016, our sales were up 1.9% with our average selling price per ton sold up 0.9% and our ton sold up 1.1%. We increased our gross profit margin for the sixth consecutive quarter to 31.1%, up from 29.4% and the first quarter of 2016 and 27.1% in the second quarter of 2015.

Along with the outstanding execution by our managers in the field that Gregg discussed previously, the increase in our FIFO gross profit margin in the second quarter of 2016 benefited from our ability to push through announced mill price increases.

When mills announce price increases we attempt to increase our selling price at date of announcement, which is before we receive the higher cost material in our inventory. This allows us to increase our gross profit margin until we receive in the higher cost material.

The increased gross profit dollars generated from both a higher gross profit margin and a higher average selling price increased our profitability at all levels with our pretax income margin increasing to 6.9% from 5.0% in the first quarter of 2016.

Similar to the prior quarter, we did not record a LIFO inventory valuation adjustment for the second quarter of 2016 as we continue to expect that overall metal prices will be higher at December 31, 2016 as compared to January 1 based on current pricing trends. This would typically 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 of cost] for market reserve established as of December 31, 2015. In the second quarter of 2015 our results included LIFO income of $32.5 million.

As a percent of sales our SG&A expenses were 20.7% compared to 18.2% in the second quarter of 2015 and 20.8% in the first quarter of 2016. On a year-over-year basis the increase as a percent of sales was mainly due to lower metal prices.

Our increased gross profit margin drove our operating income margin up to 7.9% for the second quarter of 2016, a significant improvement from 6.6% in the second quarter of 2015 and 6.0% in the first quarter of 2016.

Our effective income tax rate for the second quarter of 2016 was 32.7% compared to 32.6% in the second quarter of 2015 and 14.4% in the first quarter of 2016. As a reminder, our tax rate in the first quarter of 2016 was significantly reduced as we favorably resolved certain tax matters that have been under examination. We currently estimate that our full-year 2016 effective income tax rate will be approximately 28%, down from 31.1% in 2015.

Net income attributable to Reliance for the second quarter of 2016 was $100.9 million or $1.38 per diluted share compared to $90.2 million or $1.20 per diluted share in the second quarter of 2015 and $92.2 million or $1.27 per diluted share in the first quarter of 2016.

Our non-GAAP earnings were $1.36 per diluted share, which was above our expectations mainly because of our stronger than anticipated gross profit margin. And this compares to $1.21 per diluted share in the second quarter of 2015 and $1.03 per diluted share in the first quarter of 2016. And please refer to our earnings release issued earlier today for a reconciliation of our non-GAAP adjustments.

Now turning to our balance sheet and cash flow, we generated $49.8 million of cash from operations during the second quarter of 2016 and $205.2 million during the first half of 2016.

Given both increased metal pricing and increased demand, we used cash to build working capital by $109 million in the first half of 2016. However, our higher gross profit margin produced cash in excess of our working capital needs with $174.7 million of additional gross profit dollars resulting from the margin expansion in the first half of 2016 compared to the first half of 2015.

Our inventory turn rate at June 30 was 4.7 times, or 2.6 months on hand based on tons. Our successful efforts to reduce inventory in 2015 allowed us to reach our companywide inventory turn goal in 2016.

At June 30, 2016 our total debt outstanding was $2.17 billion and our net debt to total capital ratio was 33.4%. We had significant liquidity with $831.1 million available on our $1.5 billion revolving credit facility.

We continue to execute our balanced capital allocation strategy of both growing the business and returning value to our stockholders. In addition to the two acquisitions we have completed so far in 2016, we spent $71.7 million on capital expenditures during the first half of 2016 primarily on purchases of new equipment to increase our value added processing capabilities. Our 2016 CapEx budget remains unchanged at $180 million.

In the first half of 2016 we paid our regular quarterly cash dividend totaling $58 million and we increased the quarterly dividend by 6.3% for the third quarter of 2016 to an annual rate of $1.70 per share, up $0.10 from our prior annual rate.

Now turning to our outlook, we continue to believe the US economy is generally healthy and anticipate a continued slow recovery in demand subject to normal seasonal factors. We are optimistic that metal pricing is sustainable at current levels through the third quarter of 2016 and we are confident in our ability to execute well in this environment.

As a result we estimate tons sold to be down 1% to 3% in the third quarter of 2016 compared with the second quarter of 2016 due to normal seasonal factors. We also expect our average selling price for tons sold in the third quarter of 2016 to be up approximately 1% to 3% from the second quarter of 2016 assuming current mill prices remain in place for the full quarter. As a result we currently expect non-GAAP earnings per diluted share to be in the range of $1.25 to $1.35 for the third quarter of 2016.

In closing, I would like to once again thank our managers in the field for their hard work and dedication to Reliance. Their successful execution of our strategy resulted in yet another quarter of FIFO gross margin expansion and strong financial results.

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 just wanted to extend my heartiest congrats to both Dave on his long-term accomplishments while he was at the helm, and also to Mark too as he takes on the new role. So wishing you guys both all the best.

So Gregg, Karla and team, excellent progress, a number of areas. I think we were most impressed by the continued ability that you guys are capturing market share. You have had six consecutive quarters of gross profit margin improvement. It is got to be disappointing when your shares are down

5% on a day you report results like this. And it would seem to indicate that there is some skepticism out there about the sustainability of these achievements.

And I was wondering, first of all, if you could provide your thoughts on this. And then maybe to how we should think about your gross margin a little bit more in a granular manner as we move forward. You said that you kind of finished the quarter with inventories where they are. So how should we think about that? Then I have got some other questions too.

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

Well, Tony, obviously we are very pleased with the 31.1% and six consecutive quarters of increased gross profit margin. There has been a tremendous amount of time and effort put forth, not only backed by our people in the field but certainly by our operators here in this office. And we couldn't be more proud of their accomplishments.

I think we mentioned on our last call about the sustainability issue, which is a legitimate question -- very legitimate. But with six quarters of increases I think we guided last time to the 28% range, thinking with the prices going up but still a little questionable that maybe that would be more prudent to go in that direction.

And then we increased it by 1.7% above that. So [above] the 29.4% that we finished the second quarter -- the first quarter with. So obviously we kind of missed the gun on that one. But I wouldn't guide to 31% or do my modeling on that. And maybe we can get a couple thoughts from Karla on that.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes, I guess first, Tony, on the stock price, certainly it is disappointing when we execute the way we do to see the stock price go down. But we are confident that everyone will realize that we deserve a higher stock price and we will see it go back up.

On the gross profit standpoint and the sustainability, as you know, we have been conservative, we typically are conservative. But we have seen very good progress for all the different reasons Gregg had in his comments. And in the second quarter we did get a little bit of a lift because mills were announcing price increases mainly on carbon steel products.

And as we have done consistently in periods of rising prices, we are typically able to expand our gross profit margin when the prices are announced before we get the higher cost inventory in. So we do believe there was a little extra expansion in the second quarter because of the timing of the price increases.

In the third quarter, assuming mill pricing remains flat, as we start to receive in our higher cost metal we do believe we will see a bit of compression from the 31.1% margin that Gregg talked about. But we do believe our gross profit margins are certainly sustainable at a higher level than the 25% to 27% we had talked about previously because of all the good things we have done with pricing, additional value add processing, good inventory management, etc.

Tony Rizzuto - *Cowen and Company - Analyst*

Right, that is a bit of a wide range there, you could drive a Class [E] truck through there a little bit (laughter) 25% to 27% to 31%. But let's maybe perhaps look at it. So if we are maybe assuming that pricing is -- may be some possibility of retracement, not a collapse but maybe taking that into account and looking at what is structurally changed with your gross margin, maybe that is a way to look at it.

I mean are we talking about a possibility of closer to 28% to 30% versus that type of level. Just trying to figure out of that how much of a boost. You mentioned a bit of a boost and I hate to split hairs on this, but it is obviously very important.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes, I think, Tony, if you look at our first quarter of this year we were at 29.4% FIFO gross profit margin, which didn't have that margin expansion from the mill price increases during the quarter. I think the current environment hasn't changed. We are still feeling good like we were in the first quarter. So I think probably something close to the first-quarter number is reasonable for the third quarter.

Tony Rizzuto - *Cowen and Company - Analyst*

Okay, okay, that is very helpful. And what can you tell us about your willingness or unwillingness to perhaps buy more foreign material? Obviously we are beginning to hear reports of obviously the widening spreads out there for some products. And with inventories seemingly quite low across the board, what can you tell us about the attractiveness of foreign material and your view towards possibly changing your behavior?

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

Tony, I think our behavior is one of the main reasons why our margins have improved to the extent that they have. We turn our inventories -- whenever we turn our inventories effectively we get a kick on our margins because we don't have to chase truckload quantities of material at low margins just to blow out inventory.

We have been doing that in the last six quarters and if we brought in foreign material it would expand our inventories and probably put us into a position where we would chase some of those orders that we choose to walk away from today.

So I think our position of keeping as much domestic material here by way of purchases has served us very well. I mean we could go out in the market and buy foreign material and go chase orders and increase our tons and make certain people that follow our stock happy because our tons are going up and all this other stuff. But we wouldn't have anything to show for it.

There wouldn't be anything on the bottom line improvement that we have seen thus far with our increase in our gross profit margin. So I think our model of keeping our purchases domestically to the extent that we have, which is about 95% of what we buy is produced in North America, has served us very, very well. And I don't see any reason to move astray from that.

Yes, some of the spreads are pretty high. But we have some very good relationships with the domestic producers and they are not going to let us get too far out of whack because if we lose position they lose position and that is a lose-lose proposition.

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

Hey, Tony, this is Jim. Another point, one of our strategies for margins was our investment in the value added equipment. That is certainly still a strategy of ours. Our budget was $180 million, it is still $180 million, we haven't spent anywhere near $180 million, we have got a long way to go.

So we have got more equipment coming in. And as the quarters roll by we will be bringing that equipment online and be able to offer our customers more activity at better tolerances. So we hope it continues to play out like it has so far.

Tony Rizzuto - *Cowen and Company - Analyst*

Do you -- all of you guys, I would be interested in hearing your thoughts. Do you believe in the theory, are you buying the theory that because inventories -- we look at the MSCI data and certain product categories extremely low and the lowest we have seen in years. Do you buy into the theory that inventories are so low and with demand relatively stable that there could be a pretty significant restock maybe in the fourth quarter?

Or do you just think it is kind of steady as she goes in terms of inventory behavior? Generally speaking now, obviously this is -- you have obviously done an excellent job. I am just asking you to think a little bit more broadly in terms of the service center industry.

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

But, Tony, I don't think there is going to be a surge in purchases from service centers, quote/unquote, restocking. I think inventories are low, I think everybody has been keeping their inventories close to their vest. I think that is the absolute right thing to do, that is certainly what we have done. And I think there is some question as to this, quote/unquote, sustainability of some of the prices that are out there today.

Certainly there is fewer imports that are coming in, fewer offerings, although that is picking up just a little bit now. But overall I think that people -- it will be more or less business as usual going through the second half of the year. What do you guys think? Do you agree with that?

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

I do. And probably the most important, Tony, is really speaking for our guys and we definitely will not be doing that. So I agree with Gregg. I don't think we are going to see any major restocking take place.

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

In my opinion, I mean when the kind of general consensus is prices are going up that is when people buy a little more. If there is a gut feel or somebody thinks the pricing may come down a hair or more imports come in people take a little bit of a pause and they want their dollar.

So we have seen -- we can only control 62 companies, we don't know about the rest of them out there, they are going to do what they are going to do. But if you look at the MSCI numbers I think the inventory is in pretty good shape right now and there is really no pressing reason to screw that up.

Tony Rizzuto - *Cowen and Company - Analyst*

Right. Listen, final question for Bill and I am going to turn it over then. So the recent affirmation against the Chinese and stainless flats, how positive an impact is that for you guys?

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

Tony, I think that is going to be very positive. I think we will see the Chinese back away from this market and I think that should be very positive for the domestic guys. And, as you know, demand has been good there and I think that will be very positive from a pricing standpoint.

Tony Rizzuto - *Cowen and Company - Analyst*

Has your competitor who is getting out of the market, have they liquidated their inventory at this point?

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

I am not sure about that, Tony.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

I don't think we can comment on that.

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

Yes.

Tony Rizzuto - *Cowen and Company - Analyst*

No worries. All right, thanks, thanks for much, all.

Operator

Jorge Beristain, Deutsche Bank.

Jorge Beristain - *Deutsche Bank - Analyst*

Thanks, guys, I appreciate Tony taking the lead there (laughter). I guess I just have a few questions remaining (laughter). Karla, my question is kind of sort of the flipside of what Tony's question was earlier. We did see the gross margin expansion of 170 basis points quarter on quarter. Yet average selling prices were actually disappointingly a bit low.

And so what I am trying to figure out is, were you fully able to affect as quickly as you say and as fully across your carbon steels the price hikes? Or could there be a little bit still in the kitty into the second half?

And then also what about other later cycle metals that we are starting to see move up in non-carbon like aluminum and stainless? Are you seeing any kind of -- I think you touched on that in your comments earlier, but some second half momentum there where maybe average selling prices will not fall as much as list prices as they start to correct? So that is my question.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes, morning, Jorge. So I think from the average selling price not going up as much as we had anticipated, if you do break it down by commodity, most of the price increases were on the carbon steel products and our carbon steel average sale price per ton was up 2.6%.

What did happen during the quarter was our average inventory cost on hand continued to trend down a bit because we were still receiving in some of the lower cost inventory that we had ordered previously.

So, I think we got the spread that we expected to get based upon the price increases that were out there, it was just off of a lower base than we had anticipated. So that is where we talked about in Q3 we think our average inventory cost will start to go up a bit as we receive in some of that higher cost inventory.

We might give up a little bit of that carbon margin spread from the price increases but we still expect the margins to be very healthy and for us to sustain our margin on those. So, I think it was really the cost going down that caused our average sell price to not be up as much as we thought it would over the first quarter.

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And to your point about the other products, yes, during the second quarter compared to the first quarter the other commodities, aluminum, stainless, alloy, we saw average sell prices down. There are some reasons out there that we might see some increases in those in the back half which could help us in those products as we pass through those price increases.

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

Yes, particularly on stainless. I think we have the opportunity there where surcharges, we expect those to go up in the second half. And then I think there is a good possibility we will see a base price increase sometime in the second half.

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

We have had a couple base price increases already first half of the year.

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

Right.

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

So, I thought that reading those trade cases on China -- okay, I know that Bill was having somewhat of a party (multiple speakers) (laughter) that could be a game changer.

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

Yes could be, absolutely.

Jorge Beristain - *Deutsche Bank - Analyst*

Great, thank you for the full response. Just one second follow-up. Just on the aluminum, you mentioned that you are basically making better margin on tolling. Could you just give us a kind of sense as to, with your aerospace exposure now at 11%, should we be expecting you to be growing sort of in-line with the build rate for aircraft going forward? Or are you expecting an above build rate growth average just because you are kind of winning market share? Just if you could just talk about that.

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

Yes, on the aerospace side, we still think we will see growth in the second half. And so, our outlook is still positive. The build rate changes that have been announced, I think we are seeing a little bit of an impact there. When we look at mill lead times, those have compressed just a bit. But that is still very dependent on what programs you are supporting. And for our guys, our outlook is still positive and we think we will still see improvement from a demand standpoint in the second half.

Jorge Beristain - *Deutsche Bank - Analyst*

Okay, thanks very much.

THOMSON REUTERS

Operator

Phil Gibbs, KeyBanc Capital Markets.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Hey, Bill, I had a question on the aerospace side as well in terms of the more moderate growth you are talking about. What is that really keyed off of?

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

Really, Phil, we are just looking at the programs we have, looking at the demand that we saw through the first half. And we think we are going to see that continue. When we say moderated growth it may not be at the same growth rate but we still see it as positive in the second half.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

How much have the lead times in general for the aerospace heat treat plate come in relative to maybe three months ago?

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

They come in like one to two weeks, Phil. So overall we have seen that -- when I said they have compressed a bit, I am really referring to a kind of a one to two week time frame.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Okay, I appreciate that. And, Jim, on the energy side I believe there were some comments about a little bit of light coming out of the darkness in the press release. Anything that you could comment on in terms of what you are seeing and what the allusion to was there?

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

Yes. When you have been down like this for a long period of time just a little bit makes you feel good. So just the quoting activity has come up a little bit. The feet drilled came up a little bit. There is been a couple of announcements where some of the big boys announced that they are going to release some CapEx dollars. And we are seeing better quoting activity. So that is what I mean by a little light at the end of the tunnel.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Perfect. And any sense you could give us as to how much inventory that still needs to be churned through maybe relative to the current rate count levels? And when we are through the kind of mopping up some of the excess pipe and tube and bar products?

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

I mean if I understand your question properly, our inventory is in okay shape. We kind of got on this early before it started really coming down. So we took a lot of inventory out before it really started crashing. I am not going to tell you we don't have some excess A items. But they are A items and we know they are going to come back.

So we keep them in line. We are not going to increase our inventories, we don't need to. If the business came back X amount a percent we would be able to absorb those orders without adding any expense and without adding a whole lot of inventory, to tell you the truth.

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

And you know we have been pleasantly surprised, okay, that the producers -- we would have expected alloy pricing to go down much greater than it actually did. In large part that is because automotive has been so strong. So there has been a lot of alloy being consumed in that market. But we think the suppliers have exercised some very prudent discipline on the pricing side. So we haven't seen the major price discounts that normally you would expect to see when business is down 40%-50%.

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

Yes and just the product itself, SBQ bar, the S stands for special, it is hard to make. There is not a whole lot of players in the game. Heavy wall tubing, those are very high quality products and thankfully, to Gregg's point, they really haven't come down as much as they could.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

I appreciate all the color. I just have a housekeeping one for Karla and I will jump off. Was your -- your tax rate guidance for the year, was that on a GAAP basis?

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Okay. Thanks so much.

Operator

Aldo Mazzaferro, Macquarie.

Aldo Mazzaferro - *Macquarie Research - Analyst*

Good morning, Karla and gentlemen. I was just wondering about the demand side a little bit more. Gregg, I think you said in your initial comments that when you made your first guidance for the second quarter you had a view of demand that came in a little bit weaker than you thought. I wonder could you specify a little bit about where those sectors were in terms of they came in a little weaker or was it generally across the board?

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

It was generally across the board. But it was fairly much in line. I think we were up 1.1% --.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes, I think out of Gregg's comment that you are talking about was more about 2016 in general compared -- for the first half. Second quarter was in line. But earlier in the year we thought 2016 was going to be a little bit stronger than we have seen it playing out.

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

Yes, when we were starting (multiple speakers) good point. When we were going into 2016 our outlook was a little bit more positive than what it turned out. In the second quarter I think we were up in tons 1.1% over first quarter, which was in line with our guidance at zero to flat to 2%. So there wasn't really any big surprise there.

Non-res came in just about where we thought it would. We have seen some improvement there. The heavy equipment, basically no big surprises there at all. Aerospace is doing well. Automotive and toll processing is doing extremely well. And as Jim mentioned in his comments, we just opened up a new facility down in Monterrey, Mexico; just had our opening day ceremonies on July 12. So we are really upbeat about that particular one.

We put a brand-new splitter in place in our Michigan operation, that was commissioned in April. So we are anticipating more growth there. We broke ground in Kentucky just recently in the last 30 days and expect to have a facility there operational to support the automotive industry that are moving into the, quote/unquote, Louisville area. And that should be open and running sometime in the second quarter of 2017.

So we are seeing -- there has been really no industry that has surprised us. We thought it might be a little bit stronger than it actually is, we are continuing to make investments like the ones that I just described. And those investments are paying off quite well.

So with those investments you go to your people and you say, we need to pay for those investments. This $180 million that we have been spending basically every year for the past five years, damn near $900 million in the last five years, we want to get paid for that stuff.

And we don't see our competition, very honestly, pouring as much money in CapEx spending, so that tells us that our tolerances are superior, okay, the finished parts are better and we want to get paid for it. So that is the message that we have given to our four op guys and they have set the guidelines for the people in the field who ultimately are the ones that execute the plan. So no big changes, Aldo.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes, Aldo, I think when we came into the year we were -- after the fourth quarter when we talked to you guys in February we were anticipating that our volumes might be up a couple percentage points for the 2016 year compared to 2015. But we have seen the overall demand down.

So, at Reliance we are done only 2.1% in tons sold; on a same-store basis for the first half of the year the industry is down 6.9%. So we think we are definitely doing well given the overall demand environment we are in. And we are kind of out beating the industry even with our higher gross profit margins we are achieving because of those reasons Gregg talked about.

Aldo Mazzaferro - *Macquarie Research - Analyst*

Great and thank you. Just a quick follow-up. I know you answered a lot of questions already. But on stainless steel specifically, are you anticipating any price gains in the second half from the tariffs that were announced on a preliminary basis?

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

Yes, Aldo, I think we said that, that we do think there is a very good potential for a price increase in the second half. And we also think that we will see continued increases on the surcharge side based on nickel pricing too.

Aldo Mazzaferro - *Macquarie Research - Analyst*

Right. Okay, thanks very much.

Operator

Timna Tanners, Bank of America Merrill Lynch.

Timna Tanners - *BofA Merrill Lynch - Analyst*

I just had two left. And I know we have probed the oil and gas end market and I know we have probed aerospace, but I just wanted to touch on the automotive industry and was really interested in the new facilities and capacity you were talking about.

Our automotive car parts are starting to get a little bit more cautious in terms of the outlook, not negative but just maybe closer to a peak. And I was wondering if you have any contracts or maybe if you are more on the aluminum side or what gives you the confidence in adding capacity at this point in the market?

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

Timna, this is Jim. I have always said when you are speeding down the highway going 85 miles an hour and you slow down to 70 you are still speeding. The automotive count is still in excess of 17 million. I think I read an article the other day where they adjusted their 2017 build down from 17.7 to 17.4, that is still a lot of activity.

And a lot of our activity happens to be in the light truck and the kind of medium duty trucks. And everything we see and the folks we deal with are telling us that the build rates are exactly what we thought they were going to be. So, we don't see in the foreseeable future any real issues. Those are tremendous numbers.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

But, Timna, even if the build rates for autos stay where they are, a lot of our investments are going into the shift from carbon to aluminum and processing a lot more aluminum. So that is why we are very bullish and see our piece of that market increasing because of that shift to aluminum that we are (multiple speakers).

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

And those (multiple speakers).

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

Basically the investments, Timna, that we have made in the United States, so the Kentucky operation, the splitter that went into Michigan and our new plant in Michigan which was April of last year and a new one -- new piece of equipment that was commissioned in April of this year, those three operations are all centered around aluminum going into light trucks.

The one in Mexico that we are opening in Monterey is not necessarily aluminum related, but we are at capacity in our plant down there. So we needed to either add on or get closer to Monterey; we decided to get closer to Monterey for logistic purposes. So that was put in there not necessarily for aluminum.

Although the piece of equipment that we put into Monterey, Mexico is designed to be able to do light gauge aluminum going into automotive. So the majority of what you are seeing, especially in the United States, is actually being put in place because of the switch from carbon steel to aluminum.

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

And one other thing to remember, Timna, we process a lot of steel that goes into the appliance industry as well. And that is strong as well.

Timna Tanners - *BofA Merrill Lynch - Analyst*

Okay, that makes a lot of sense. Thanks for that answer. The only other question I had for now is just in terms of the guidance I wanted to clarify, because you made the comment here assuming current mill prices remain in place for the full quarter.

And I am not as sophisticated on how long products are priced on the carbon steel side. So I was just wondering is that already baking in the recent declines in scrap prices. Or any declines that may result from what is happening in Turkey and the weakness there or what scrap price might that be baking in when you talk about current mill prices?

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes, I think we didn't put anything in specifically because of what is going on in Turkey or pull it down. So kind of the general prices. Remember we have got a very broad product mix. And scrap certainly impacts many of our products but I think we are still kind of consistent with where prices have been over the last three to four weeks in our guidance.

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

Yes, and the scrap is going to probably have more of an impact on the mini mill product -- the long products that you are referring to. But they have pretty good discipline in those products through the years. And they may go down, we are not anticipating that they will.

But even if they do they are not going to go down, in our opinion, significantly or dramatically that is going to make any impact on us one way or the other. So we are not overly concerned about that. But it wouldn't shock us, but right now we are of the opinion that it is going to remain fairly flat.

Timna Tanners - *BofA Merrill Lynch - Analyst*

Okay, thanks, guys. I appreciate it.

Operator

Michael Gambardella, JPMorgan. Michael, you can proceed with your question. Can you please check to see if your phone is on mute?

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

Well, that was easy to answer.

Operator

Chris Olin, Rosenblatt Securities.

Chris Olin - *Rosenblatt Securities - Analyst*

I just have a basic question. A couple companies have started to mention weather, especially the rain in taxes, as part of an issue in the past quarter. I was just wondering if you think you lost any volumes because of the amount of rainfall and your leverage to construction markets.

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

No, I don't think we do. When we have weather issues, whether it is in the wintertime in Cleveland, Ohio or rain in Texas, if we lose a day we pick it up the next day. Because you always end up getting the orders you were going to get but they just get pushed out in the future. So, no, I wouldn't -- we don't blame things on weather.

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

Yes. Rarely will you ever hear us say anything about our business of being negatively affected by weather conditions, unless there is an absolute devastating five-day hailstorm (multiple speakers), right. Because the orders are still there, the fact of the matter is we just can't ship them because either issues on the road or our customers aren't open to receive it. But at the end of the day, whether it be at the end of the month or the beginning of the following month, it is going to ship.

So it has not been an issue with us and we have had certainly some complaints about 14 inches of rain in 24 hours and stuff like that, but I haven't heard and got -- by the mercy of God, none of our people have been affected, they are all healthy and whatnot, that is the most important thing. But I haven't heard any, and if Jim would have heard something I would have heard it. So the answer to your question is, no, it is business as usual at Reliance.

Timna Tanners - *BofA Merrill Lynch - Analyst*

Okay, thanks a lot.

Operator

(Operator Instructions). John Tumazos, John Tumazos Very Independent Research.

John Tumazos - *John Tumazos Very Independent Research - Analyst*

I just wanted to thank Dave and congratulate Dave on his retirement and the whole team under -- for the accomplishments of the last 22 plus years. When you think about it, even Ken Iverson at Nucor made a mistake once, iron carbide or steel concrete railroad ties 50 years ahead of the railroad industry.

Or maybe [Tom Graham] once or twice spent money on an oilfield tube machine or an automotive processing plant that didn't earn returns the first 10 years. A lot of people -- I don't think Reliance has made a significant strategic mistake since it has gone public and God bless you.

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

We had good leadership with Dave, that is for sure.

John Tumazos - *John Tumazos Very Independent Research - Analyst*

Well the team, the team too.

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

Yes.

John Tumazos - *John Tumazos Very Independent Research - Analyst*

So, with regard to several metrics I am trying to remember what are the best ones ever? Is the 31.1 FIFO margin the best ever? And could you just refresh us as to what was the best quarterly revenue ever, the best quarterly tonnage ever and the best quarterly EPS ever? And it is so extraordinary to have the record margin without having record volume and price, you must have really bought steel well at the beginning of the price runoff.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes, I think, John, as far as the question on records, the FIFO gross profit margin in the quarter of 31.1% I thought that probably had to be a record. But we went back and in 2004 when we had that first price spike there were -- the second, third and fourth quarters of 2004 -- or first, second and third quarters we were actually a little bit above that with the record at 34.3% during that time.

Revenues -- we are not quite there because pricing is still down, we have been building the Company. But the third quarter of 2014 was kind of a record there. And from an EPS standpoint we hit our record in the second quarter of 2008. Prices per certainly a lot different in the second quarter of 2008 than they are now.

And I think we would easily beat that with the fundamental improvements we have made in the business through the companies we have acquired and through the value add that we have added and the way our people are executing on getting the margin. So I think with that pricing, like I said, we would be there. But we feel really good about how we have performed in the current environment.

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

John, speaking from our team's point of view, we really appreciate that question. It is very valid. But we had a Board meeting last night and a Board member brought up the very question about our 31.1%. And I happened to glance at the report Karla is looking at today. And I said, no it is not a record but is the best GP percent we have had in the past 12 years.

So, I can't tell you how proud and excited we are as a management team here that we are able to do that. And out of the six consecutive increases in GP per quarter, four of those quarters were in 2015 when prices were going down. And 9 times out of 10 when prices are going down your margins are going right down with it.

We reduced our inventory in 2015 by $433 million and we increased our gross profit margins at each one of those quarters throughout that particular year. And I have to tell you, there is not a whole lot of companies I have ever seen when prices fall 15 months in a row that are able to increase their prices every single quarter throughout a year like that. So it was a heck of an accomplishment.

And I think what it did for us, it just gave our team, both here and in the field, a lot more confidence in our ability to be able to sell product at higher prices based on the processing that we are doing and the outstanding commitment to customer service that we have. So, you can ask those questions to us any time (laughter).

John Tumazos - *John Tumazos Very Independent Research - Analyst*

If you could elaborate on the 1% to 3% up pricing guidance for the third quarter. Nickel is up almost $1 now and stainless is strong. I don't think any of the nonferrous prices are worse right now. Do you think you might be a little conservative on that or do you think steel is softening?

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

We are thinking steel is pretty flat. Okay, for the quarter that is our best guestimate is that steel would be pretty much at flat levels throughout the third quarter. We are anticipating a kick in the stainless. But normally that takes a little bit of time to work its way into the marketplace.

So, our guidance is considering that to be a little bit flat. But if this trade case kicks in it is probably not -- it is not going to affect us in the third quarter, but it could have an impact in the fourth quarter.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes, and in all honesty, John, we're probably a little more hesitant of the price increase in Q3 versus Q2 since we missed a bit on Q2 versus Q1. I mean carbon was there and also with our product mix in the third quarter stainless is about 14% of our total sales dollars.

A lot of our stainless products are sold into the energy industry. So we don't know that we will necessarily get the bump as quickly on those stainless steel products as we will on the flat rolled and some of the other stainless products. So certainly we think it is positive. As you know, we are generally conservative or try to be in our guidance. So there is some upside there.

John Tumazos - *John Tumazos Very Independent Research - Analyst*

Could you elaborate on the 11% of your total revenue now from aerospace and just review how much of it is aluminum versus jet engine alloys or which parts of the plane, fasteners or --? And if it is helping contribute to the 31.1% higher margin?

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

John, I will take that, it is Bill. I think of that 11%, most of it is on the aluminum side. And so probably --

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Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

It's probably about 9%.

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

-- about 9% of that mix would be on the aluminum side. Then the balance would be in those specialty alloys, the aerospace steel and titanium products. And it goes across a wide range of end uses. On aerospace steel we are a big player in landing gear and on the aluminum side with monolithic design for aluminum plate, it goes really all over the airframe.

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

Of that 9% though, Bill, what would you consider to be our plate?

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

A significant part of that is plate. I mean --.

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

70 --?

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

Yes, probably 70%, 75% of that would be on the aluminum plate side.

John Tumazos - *John Tumazos Very Independent Research - Analyst*

If I could just interject on the stainless and the nickel. There is a real sweet lady in the Philippines that is the Minister of Environment and Mines, natural resources -- she was to close every open pit mine and outlaw the use of explosives. And last year the Philippines were 23% of world nickel mine output in the first -- even through the first half of this year they are still number one. So there is a new patron saint of the nickel market out there (laughter).

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

We will get on our knees and say a prayer for her.

John Tumazos - *John Tumazos Very Independent Research - Analyst*

Yes, I have got my rosary beads in my hand.

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

(Laughter) I got you.

John Tumazos - *John Tumazos Very Independent Research - Analyst*

Take care.

Operator

Michael Gambardella, JPMorgan.

Michael Gambardella - *JPMorgan - Analyst*

Sorry, I got disconnected before. Congratulations on the quarter. And just wanted to get some color on the processing end if your business, the tolling business. Can you give us an idea -- the gross profit margin in the quarter, 31% what would that be if you excluded the processing part of your business?

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes, so the toll processing part, Mike, does have higher gross profit margins than the other part of the business. So it brings it up a bit, but it is right around 3% of our sales dollars. So it is not moving it significantly.

So we saw that trend in the gross profit margin percent truly was across the Company. It wasn't achieved only because of the toll processing. Toll processing helps pull it up a bit, but the rest of our operations all increased their gross profit margins and really had that improvement that you see in the total GP percent.

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

We take a look at that basically every month. And as happy as we are with the toll processing operations and their contributions to earnings, and believe me, we are. But as a whole when you look at all of the entire Corporation, basically every business unit had increased gross profit margins over the past six quarters.

Michael Gambardella - *JPMorgan - Analyst*

Right. But the toll processing business, I mean their gross profit margins must be more than double what the Company reported, right?

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Not at the gross profit margin level. They are significantly better than the companywide average, but not to that extent. When you go down to kind of the pretax -- operating income or pretax, you are going to see a higher multiple to the companywide average produced by our toll processing company.

Michael Gambardella - *JPMorgan - Analyst*

But you are saying that the total revenue on toll processing is 3%?

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Of total sales dollars, because remember we are only charging for the processing fee.

Michael Gambardella - *JPMorgan - Analyst*

Right.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

So 3% of total sales dollars, but it is a bigger percentage of the operating income or pretax income line.

Michael Gambardella - *JPMorgan - Analyst*

And that tends to be stickier business, right, than the vast majority of the other business?

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes, it is kind of high volume long run, where the customers where -- we are seeing with there we are going into large pieces of business.

Michael Gambardella - *JPMorgan - Analyst*

And that is contracted on an annual basis?

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

Actually, when we get into contracts there, they are more agreements that we have with the suppliers and the end-users. Of course the suppliers are ultimately our customer. But we are also very, very close with the end-user, so we understand the quality needs of that end-user.

So, it is not like you walk into a signed agreement, it is a handshake agreement that this is what you are going to do and these are the volumes associated with it. And this is what our price is for the various processes that we perform.

So it is -- you have to understand, our business on toll processing is a little bit different than the majority of toll processors in that we do the really, really difficult things that most toll processors don't even want to touch.

We do processing at our total processing operations that we could not do in any of our service centers throughout the country, okay. They are very niche orientated and it is very, very high quality needs. So we don't have a tremendous amount of competition. And we do a really good job with that. But we don't have a firm commitment for a year with basically anybody.

Michael Gambardella - *JPMorgan - Analyst*

Okay, and is that part of the reason why your capital expenditure commitment is higher than some of your competitors?

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

It definitely is. Some of the equipment that we put in -- well, let's put it this way, the most expensive equipment that we put in at Reliance Steel is associated with our toll processing operations.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

But even outside of that, putting the toll processing investments aside, Mike, we still spend significantly more than our competitors on capital expenditures and putting in kind of new state of the art equipment into our facilities.

Michael Gambardella - *JPMorgan - Analyst*

Okay and just on (technical difficulty), I assume this is in the 10-K, I can look it up. But what percent of the locations at this point if you look at on a square footage basis is owned versus pleased?

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Sorry, Mike, give me one second here. I am flipping in our 10-K.

Jim Hoffman - *Reliance Steel & Aluminum Co. - EVP & COO*

It is the only number Karla doesn't have memorized (laughter).

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

If we just had our big table, so it is harder for me to find right now. I think it is the majority, Mike -- wait, got it. So, about 80% of our total square footage in our operating facilities we own.

Michael Gambardella - *JPMorgan - Analyst*

Great. Thanks again and congratulations on the quarter.

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

Thank you very much.

Operator

Phil Gibbs, KeyBanc Capital Markets.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

I think at this point my questions are answered (laughter). Actually, I just remembered it. It was a question on the sheet business, because I think you acquired a lot of that from Metals USA. So was there a lag -- is there a lag, Karla and Gregg, in terms of the pricing there? Is more of that business on a CRU reset?

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

The contract business that -- in carbon steel that we have with the Metals USA companies, a degree of that is based on crew, okay. So whenever you have any contract based on that index there is a lag. So what you see in a particular month or quarter, I should say, could lag the market and then you can get higher margins in the following quarter.

And just the opposite, if prices go down you might have higher margins this quarter and lower margins the next quarter. So, yes, there is. But if you look at our total Company, okay, as a whole, what that lag is, whether it is going up or it is going down, is relatively insignificant when you look at the entire scheme of things. It is not something that I would worry about.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Okay. I was just trying to gauge in your carbon steel portfolio if you had a lot of lag (inaudible) business. And I think if you had -- in my mind if you had any it would be in the sheet side, but it sounds like even that is pretty mixed.

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

It is, it is. It is a good question. And we don't have the crew on anything other than the carbon steel flat roll business. We don't have it in the other products.

Karla Lewis - *Reliance Steel & Aluminum Co. - Senior EVP & CFO*

Yes, and carbon flat rolled is 15% of our total sales dollars, 3% of that is hot rolled -- I'm sorry, 6% is hot rolled, the rest is in kind of galvanized -- the majority is in galvanized and then cold rolled.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Okay. Thanks so much.

Operator

There are no further questions at this time. I would like to turn the call back over to Gregg Mollins for any closing comments.

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

Okay thank you for joining us today. I would just like to reiterate the fact that our focus is on maximizing earnings, not tons or sales. And that starts with gross profit margin which is why we speak so much towards that particular bottom line. We are not a tonnage type Company, we are an earnings Company. So I just wanted to reinforce that.

Also, I would like to -- we would like to remind you that in mid-September we will be in Boston presenting at the KeyBanc basic materials conference and we hope to see many of you there. Thanks for joining us and have a great day.

Operator

This concludes today's conference. Thank you for your participation. You may disconnect your lines at this time and have a wonderful day.
