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# EDITED TRANSCRIPT

## RS - Q3 2016 Reliance Steel & Aluminum Co Earnings Call

EVENT DATE/TIME: OCTOBER 20, 2016 / 3:00PM GMT

**OVERVIEW:**

Co. reported 3Q16 sales of $2.2b and net income attributable to Co. of $49.5m or $0.68 per diluted share. Expects 4Q16 non-GAAP diluted EPS to be $0.65-0.75.





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## CORPORATE PARTICIPANTS

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

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

## CONFERENCE CALL PARTICIPANTS

**Jorge Beristain** *Deutsche Bank - Analyst*

**Aldo Mazzaferro** *Macquarie Research - Analyst*

**Phil Gibbs** *KeyBanc Capital Markets - Analyst*

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## PRESENTATION

**Operator**

Greetings and welcome to the Reliance Steel & Aluminum Co. third-quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded. It is now my pleasure to introduce your host Brenda Miyamoto, Investor Relations. Thank you, you may begin.

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**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 third-quarter 2016 financial results.

I'm 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 investor 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.

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

Good morning, everyone, and thank you for joining us today. I continue to be very pleased with our operational performance.

After six consecutive quarters of increases in our non-GAAP FIFO gross profit margin our margin in the third quarter declined slightly to 30.0% from 31.1% in the second quarter of 2016. However, we believe the 30% level is still outstanding and came in above our expectations.

As we communicated to you during our last call, our second-quarter FIFO gross profit margin of 31.1% included incremental margin achieved because of multiple mill price increases that were announced during the second quarter that allowed us to increase our selling prices before receiving the higher cost metal in our inventory. While we maintained the higher selling prices during the third quarter our inventory costs also increased, offsetting the incremental margin gains. The pricing discipline of our managers in the field along with diligent inventory management and our significant investments in innovative, value-added processing equipment contributed to our ability to achieve a 30% non-GAAP FIFO gross profit margin in a weakening pricing and demand environment.

As a result of the multiple price increases announced by the mills throughout the second quarter, mainly for carbon steel products, our third-quarter average selling price was up 4.4% over the prior quarter, above the high end of up 1% to 3%. However, the positive metals pricing environment began to lose momentum as the third quarter progressed and prices have continued to decline thus far into the fourth quarter.

The trade cases filed by the US producers coupled with production capacity discipline by the same mills continue to be supportive of domestic pricing. However, overall softer demand experienced in the third quarter along with normal seasonal factors heading into the fourth quarter have contributed to current pricing pressure, most notably for carbon steel products. Bear in mind our average selling price for the first nine months of 2016 was down 9.5% from the same period in 2015, which has a significant impact on our earning levels.

As far as demand goes, while it has been lighter so far in quarter four and overall not as strong as we had originally anticipated heading into 2016, we believe customer demand levels are generally healthy and inventory positions are lean. Our tons sold for the third quarter declined by 4.9% from the second-quarter 2016 which was above our expectation of down 1% to 3% but consistent with MSCI industry average decline of 4.9%.

Overall demand for metal products weakened in the third quarter more than we had anticipated which we believe was due to decreased mental pricing as well as general economic and political uncertainty. We believe our exposure to a broad array of products and end markets helps mitigate declines in any one market. The automotive and aerospace markets continue to be strong for us while other markets are not performing as well.

Our diversification strategy together with our decentralized operating structure, investments in value-added processing equipment and focus on customer service have once again contributed to our ability to increase Reliance's marketshare. For the first nine months of 2016 we outperformed the industry with our same store tons sold down only 2.7% compared to the first nine months of 2015 versus the MSCI industry average shipments which were down 6.8% in the same period. Our gross profit margin continues to benefit from our focus on inventory management with our 2016 inventory turn rate of 4.6 times mirroring our company-wide target of 4.7 times.

We believe in an efficient inventory position benefits our gross profit margin by allowing us to focus on higher-margin business. Our successful reduction of $433 million of inventory in 2015 and further reduction of $95.5 million through the first nine months of 2016 has generated significant cash which we have used to invest in value-added processing equipment and to acquire higher-margin companies, both of which enhance our gross profit margins. We believe one of our strengths at Reliance is to focus on the areas of our business that we can control and to quickly react to changes that are outside of our control.

As we have communicated on prior calls, our energy business has declined significantly as a result of the downturn in oil prices and drilling activity that began near the end of 2014. Although we have consistently reacted to declines in this market we made the decision during the third quarter of 2016 to close a few of our facilities and take asset write-downs on certain of our businesses, servicing the energy market as our long-term outlook deteriorated from our view a year ago. As a result we recorded a $67.3 million pre-tax impairment and restructuring charge in the third quarter.

We do not take these actions lightly due to the impact to our employees and customers. But we believe they are necessary to enhance our overall operating efficiencies and long-term profitability.

Turning to M&A, we are very proud of our track record of completing the acquisitions of 62 quality companies since our 1994 IPO. Three of those were completed this year: Tubular Steel, Best Manufacturing and Alaska Steel Company.

Our most recent acquisition, which closed effective August 1, was Alaska Steel, a full-line metal distributor that broadened our geographical reach with our first entry into the Alaskan market. Alaska Steel provides steel, aluminum, stainless and specialty metals and related processing services to a variety of customers in diverse industries throughout Alaska including infrastructure, energy and mining.

Since joining the Reliance family all three of these acquisitions have been performing in line with our expectations from both an operational and profitability perspective. And our pipeline for potential future opportunities remains strong. We focus on companies that are well run and fit our diversification strategy, often providing specialized products and high levels of value-added processing services.

As we look to the future we expect to stick to our tried-and-true growth strategy focused on both acquisitions and organic capital investments. These capital investments are made possible by our strong cash flow generation.

I will let Karla dive into the specific shortly, but as I think about our capital allocation priorities we expect to continue to return excess cash to our stockholders through the payment of quarterly dividends. We most recently increased our regular quarterly dividend by 6.3% effective for the third-quarter 2016, marking the 23rd increase since 1994 IPO. We have consistently paid regular quarterly cash dividends for 57 consecutive years.

Before I conclude, I would like to extend my welcome to our two new members of the Reliance Board of Directors, Karen Colonias and Douglas Stotlar. Both joined the Board as independent directors at the beginning of October, increasing the size of the Board from nine to 11. Both of these directors are already highly engaged and we look forward to benefiting from their extensive board and management experience.

In summary, despite the ups and downs we have experienced in this year's pricing environment, I commend our managers for their phenomenal ability to execute throughout all cycles. I am pleased with our financial performance for the third quarter which was characterized by ongoing pricing discipline as well as effective expense and inventory management. For the balance of the year and into 2017, we will continue to stay the course with a focus on growth through organic investments and acquisitions as well as a continued strong operational execution.

I will now have the call of it at Jim to comment further on our operations and market conditions. Jim?

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

Thanks, Gregg, and good morning everyone. I will begin by commenting 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 will then address our aluminum and stainless steel products and related end markets.

Demand for automotive remains strong at current production rates. We service this market mainly through our toll processing operations in the US and Mexico. We continue to increase our volume process for the automotive industry at strong rates, mainly because of the increased demand for aluminum used in automotive.

We began processing aluminum in the automotive industry in 2015 and since then we have continued to increase both our processing volume and capital investments in this area. In 2016 we have added equipment in our existing locations to support increased aluminum processing and we will be opening a new facility in Kentucky in mid-2017 to support both aluminum and steel processing in that region. As announced on our last call our new facility in Mexico commenced operations in July to support increased automotive activity in that area.

We anticipate we will have the facility running it close to capacity by early 2017. As Gregg discussed we remain committed to our focus on growth in our businesses that serve the automotive market and are very well-positioned from a capital perspective to continue pursuing organic investments. With our processing volumes increasing at a rapid rate we will continue to add incremental capacity as we see best fit to drive improved profitability.

Third-quarter demand in heavy industry, which includes rail car, truck trailer, shipbuilding, barge manufacturing, tank manufacturers and wind and transmission towers was down compared to the second-quarter 2016 levels. Heavy industry include sales to agricultural equipment OEMs which has been a weaker area of that market. That said due to our exposure to mostly small and midsize agricultural equipment versus the larger equipment we have been able to mitigate some of the negative sales impact.

In addition, we are hopeful that demand trends in the road construction equipment market may improve in 2017 due to the five-year infrastructure bill that was passed in December of 2015. Demand in non-residential construction market has been characterized by steady upward growth with improvements in our tons shipped. We anticipate the slow but steady growth in demand will continue to improve in 2017, though volume is still far below peak levels.

As such, we are continuing to invest in processing equipment for the business we sell into this market to ensure we are providing the highest possible level of service to our customers. Increased volume will be absorbed into our existing cost structure as this end market improves over time.

Demand for energy, which is mainly oil and natural gas, remains weak during the third quarter due to continued low levels of drilling activity. That said, there has been some encouraging signs of new activity taking place that leads us to believe we are at or near the bottom of this downturn.

Four our managers in the field our quoting activity improved during the quarter and since May rig counts were up about 30%. When drilling rigs start back up again we will be well-positioned to support this activity.

That said, due to the changes in global markets as well as advancements in technology that have made drilling for oil and natural gas far more efficient than in the past with potentially less steel required, we have further reduced our long-term outlook for this recovery and our businesses servicing the energy industry. As a result, we recorded a pre-tax impairment and restructuring charge in the third quarter mainly in connection with the closing of a few facilities and asset write-downs related to certain of our businesses servicing the energy end market.

Pricing for carbon steel products was generally higher in the third quarter due to multiple mill price increases announced during the second quarter that allowed us to raise our selling price. However, carbon steel prices began trending downward during the third quarter and we see that trend continuing into the fourth quarter.

I echo Gregg's comments that the multiple carbon steel trade cases filed in the US and production capacity discipline by our domestic producers have been generally supportive of domestic pricing. However, the overall softening in demand in the third quarter and normal seasonal factors impacting demand in the fourth quarter are pressuring prices. Lastly, for our alloy products, the majority of which are sold into our energy end markets, base prices have continued to decline, though at a slower rate than demand.

I will now have the call over to Bill to comment further on our non-ferrous markets. Bill?

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

Thanks, Jim. Good morning everyone.

Today I will be reviewing pricing and demand for our aluminum and stainless steel products. I will also touch upon some of the key industry trends and the markets we sell these products into.

Before that I would like to congratulate our managers in the field for managing through this difficult pricing environment. Keep up the good work.

I will begin with aerospace, which continues to be a strong end market for Reliance. There have been negative reports of slowing demand in this market, but we expect that most of these changes will impact the aluminum producers more than they will impact our business. We consider build rates, leadtimes and backlog to be key indicators of health for the aerospace market.

Looking ahead to the fourth quarter we've been seeing some downward adjustments on build rates, primarily in the twin aisle wide-body jet business. We expect these adjustments to remain somewhat steady through the remainder of the year.

Leadtimes have shortened significantly since January when we saw leadtimes of about 11 to 17 weeks with very tight supply. Today we are experiencing leadtimes of about seven to nine weeks and supply is much more available. However, the backlog for orders of commercial planes remains very healthy.

In addition, in 2017 we will begin supporting the five-year $350 million Joint Strike Fighter program that will add to our already strong aerospace presence. Based on these trends our outlook in the aerospace market remains positive.

The majority of these products that we sell to the aerospace market are heat-treated aluminum products, especially plate, as well as specialty stainless steel and titanium products. As stated, mill leadtimes for heat-treated aluminum plate have shortened since the second quarter, which has put some pressure on pricing. As a result, we expect to see some pressure on margins for both aerospace and general engineering aluminum plate for the remainder of the year.

Common alloy aluminum pricing has remained stable and volume has increased modestly. Most of our common alloy aluminum products are 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.

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, remains strong. Stainless still pricing improved somewhat on solid demand.

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 fourth quarter.

Thank you for your time and attention today. With that I will now turn the call over to Karla to review our third-quarter financial results. Karla?

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

Thanks, Bill, and good morning everyone. Our sales in the third quarter of 2016 were $2.2 billion, down 4.4% from the third quarter of 2015 with our tons sold down 2.7% and our average selling price per ton sold down 1.8%. On a same-store basis, which excludes the sales of the three companies we acquired in 2016, our tons sold were down 4.0% and our average selling price was down 2.3% year over year.

Compared to the second quarter of 2016, our sales were down $18.7 million or 0.8% with a 4.9% decline in our tons sold mostly offset by a 4.4% increase in our average selling price per ton sold. Although metals pricing began to decline in the third quarter of 2016, our average selling price was higher because of the price increases that occurred in the second quarter and held through most of the third quarter.

Our non-GAAP FIFO gross profit margin was 30.0% in the third quarter of 2016 compared to 31.1% in the second quarter of 2016 and 26.5% in the third quarter of 2015. Since the fourth quarter of 2014 we increased our FIFO gross profit margin in each successive quarter through the second quarter of 2016. The sequential decrease of 1.1% in our non-GAAP FIFO gross profit margin in the third quarter was expected.

In the second quarter of 2016 we were able to expand our gross profit margin as multiple mill price increases were announced, allowing us to push through the higher price to our customers in advance of receiving the higher cost metal in our inventory. During the third quarter of 2016 as we received the higher cost metal in our inventory prices leveled off and then began to decline somewhat, eliminating the margin expansion achieved in the prior quarter. With that said, we are very pleased with our gross profit margin and overall operational performance.

Metal pricing has a significant impact on our sales and earnings levels. And although metal prices improved in the second quarter of 2016 our average selling price for the first nine months of 2016 was still 9.5% or $153 per ton below are average selling price for the first nine months of

2015. This reduced our sales by about $680 million, also reducing our gross profit dollars most of which would have fallen to our operating and pre-tax income amount.

However, because of our 340 basis point increase in our gross profit margin to 30.2% in the first nine months of 2016 we earned approximately $220 million more gross profit dollars than we would have earned in our nine-month 2015 gross profit margin of 26.8%. In other words, compared to the first nine months of 2015 we generated more gross profit dollars in the 2016 period on $680 million less sales, demonstrating the positive impact of our higher gross profit margin.

We currently anticipate that the declining metal price trends that began in the third quarter to continue through the fourth quarter with our inventory cost at the end of 2016 expected to be lower than at the end of 2015. Until this time we had anticipated that our inventory cost at the end of 2016 would be generally the same as at the end of 2015, resulting in no LIFO inventory valuation adjustment for 2016.

But because of our updated outlook, however, we now estimate a pre-tax inventory valuation adjustment of $15 million of income for the 2016 year with $11.3 million included in cost of sales in the third quarter of 2016 compared to a pre-tax LIFO credit or income of $35 million in the third quarter of 2015. We did not recorded LIFO inventory valuation adjustment in the first half of 2016.

As a percent of sales our SG&A expenses were 20.8% compared to 18.8% in the third quarter of 2015 and 20.7% in the second quarter of 2016. On a year-over-year basis the slight increase as a percent of sales was primarily due to lower metal prices and tons shipped. However, when excluding the non-GAAP charges our SG&A expense declined by $7.3 million or 1.6% in the third quarter of 2016 from the prior quarter.

Our operating income margin during the third quarters of both 2016 and 2015 were impacted by impairment and restructuring charges mainly related to our businesses servicing the energy end market and pre-tax amounts of $67.3 million in 2016 and $55.5 million in 2015. Excluding the restructuring and impairment charges our non-GAAP operating income margin was 7.3% in the third quarter of 2016, up from 6.9% in the third quarter of 2015 mainly because of our higher gross profit margins.

Our effective income tax rate for the third quarter of 2016 was 28.2% compared to 32.1% in the third quarter of 2015 and 32.7% in the second quarter of 2016. Our projected annual effective income tax rate for 2016 is 27.5%, down from 31.1% in 2015.

Net income attributable to Reliance for the third quarter of 2016 was $49.5 million, or $0.68 per diluted share. Our non-GAAP diluted earnings per share were $1.25 in the third quarter of 2016 compared to $1.16 in the third quarter of 2015 and $1.36 in the second quarter of 2016. 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, because of our effective working capital management and strong gross profit margin we generated $182.4 million of cash from operations during the third quarter of 2016 and $387.6 million during the first nine months of 2016. Our 2016 year-to-date inventory turn rate at September 30 was 4.6 times or 2.6 months on hand based on tons. This is just below our company-wide inventory turn goal of 4.7 turns.

As previously announced, on September 30 we entered into a new five-year $2.1 billion credit agreement comprised of a $1.5 billion unsecured revolving credit facility and a $600 million unsecured term loan. The terms of the new credit agreement are substantially the same as our prior credit agreement including pricing. We intend to use borrowings on our revolving credit facility to retire $350 million of 6.2% senior unsecured notes when they mature on November 15, 2016, which is expected to create pro forma interest expense savings of approximately $15 million per year on a go-forward basis.

At September 30, 2016 our total debt outstanding was $2.1 billion and our net debt to total capital ratio was 32.2%. As a result of our new credit agreement, we have ample liquidity to continue funding our growth and stockholder return activities with $1.1 billion available on our $1.5 billion revolving credit facility.

We used our strong cash from operations to both grow the Company and return value to our stockholders. In addition to funding the three acquisitions we've completed so far in 2016 for a total of $349 million, we used our cash from operations and borrowings on credit facility to find

$110.6 million of capital expenditures, primarily on purchases of new equipment to increase our value-added processing capabilities and to pay quarterly cash dividends totaling $89.5 million to our valued stockholders.

Now turning to our outlook, we continue to believe the US economy is generally healthy and we anticipate a continued slow recovery. However, given the increased uncertainty in the market at this time along with fewer shipping days in the fourth quarter due to holiday-related customer closures, we are conscious in regard to those business activity levels and metals pricing in the fourth quarter.

We estimate tons sold to be down 5% to 7% in the fourth quarter of 2016 compared to the third quarter. We also expect that metals pricing for most of the products we sell will continue to experience downward pressure in the fourth quarter and, therefore, we expect our average selling price will be down 1% to 3% from the third quarter of 2016. As a result, we currently expect non-GAAP earnings per diluted share to be in the range of $0.65 to $0.75 for the fourth quarter of 2016.

In closing, despite a quarter that was characterized by softer than anticipated demand and metals pricing we continue to be very pleased with our overall financial performance. Our managers in the field have once again exceeded our expectations.

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?

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Jorge Beristain, Deutsche Bank.

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**Jorge Beristain** - *Deutsche Bank - Analyst*

Hey guys, well thank you for taking ahead on, head on, I guess, the issue about the aerospace destock but I'd like to dive a little bit more deeply into that. Could you just clarify why you believe the impact will be harder on the manufacturers than the service centers? That's my first question.

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

Go ahead, Bill.

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

Yes, a lot of the business, particularly on the larger planes, is mill direct, things like wing skins, fuselage skins, wing plate. So it will, we will see a bigger impact at the mill level versus our model where we are supplying cut-to-size just-in-time. Some markets over, particularly in Asia, it's more of a full plate market in the mills, it's more where it's more mill direct business.

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**Jorge Beristain** - *Deutsche Bank - Analyst*

Okay, that makes sense. If you could just talk about if you are seeing an inflection on the horizon in steel prices, perhaps?

I just hopped off the call with Steel Dynamics. They seem to be hopeful that things were kind of bottoming. And just seeing if you are seeing any kind of mounting evidence that buyers may be starting to anticipate maybe a fourth-quarter inflection coming?

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

As far as we can see, with scrap potentially going up has gone down a little bit and there's been a reflection of that on price discounting on the carbon steel side with the exception of the $30 a ton increase on plate that Nucor announced just recently, which remains to be seen if that's going to hold or not. We hope it does but it's still out there.

As far as price is concerned, we are just going to have to wait and see. It appears that imports are not as strong as they were last year. However, they are still in the marketplace.

So with demand going down last quarter compared to the second quarter, 4.9% for us in tons and we are anticipating 5% to 7% down in the fourth quarter, demand is softer than we would like it to be, softer than we thought it would be and pricing generally follows demand levels. So we'd love to see a price increase, in particular on flat-rolled products. We think it would be appropriate to stop the bleeding, if you will, but we are not the mill, so we are just hopeful that their discipline will work out over the long haul.

But, nonetheless, we can control what we can control and the bottom line is Reliance is doing just fine and we will continue to do so. But there is things that are out of our control and demand is one of them and pricing from the mill is the other one.

So we will just wait and see and we will do exactly what we've been doing in the past. We are going to control our inventories. We are going to turn as best as we possibly can.

We are going to manage those gross profit margins as best we possibly can. I think our people in the field have done a marvelous job in doing that. So we are just going to keep our business model in place and continue to do the best job we possibly can in blocking and tackling, and I think we've proven that through many years.

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**Jorge Beristain** - *Deutsche Bank - Analyst*

Okay, thank you very much.

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**Operator**

Aldo Mazzaferro, Macquarie.

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**Aldo Mazzaferro** - *Macquarie Research - Analyst*

Good morning. I was wondering on the volume question whether you can say whether the declines you have seen are resulting from anything like higher prices or people shifting manufacturing offshore in response to the fact that US pricing is so much higher than the world at large? Can you comment on that and whether you are seeing any kind of regional pattern to where the weakness seems to be showing up in the fourth quarter?

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

Aldo, this is Gregg. How are you doing?

Listen, we are not seeing any manufacturing moving overseas. None of that would impact our fourth quarter. We are just seeing some uncertainty in the marketplace with our customer base.

They have seen declining prices. They don't know if it's hit bottom or not so they are buying for need only, which does well for us because we can deliver next day on just about everything.

So it's just I think our management team believes that there is just uncertainty. It's economic uncertainty, it's political uncertainty. People are just buying absolutely what they need and no more.

But we also believe that the inventory levels at our customer base as well as our peers are in pretty damn good shape. So 4.6 turns up for us. We're -- it hasn't hit our goal but it's 1/10 of 1% below our goals.

So I would not model in that there is any material change with respect to manufacturing going offshore. I don't believe that's taking place. I haven't heard anything from the field or from our VPs about that, so it's just as big as that word is, uncertainty, that really is the word.

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

And Aldo, this is Jim. On the positive side, the energy market has been, it's been just dead for it seems like forever but it's only been a couple of years.

And we're actually seeing some positive signs. Better quotes coming in, getting orders that haven't been there for a while, positive talk for 2017 about the dollars that will be spent in completion of rigs. And so we're optimistic about that.

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**Aldo Mazzaferro** - *Macquarie Research - Analyst*

Okay, thanks. I will hand it off and I will stay on for maybe another one later. Thanks.

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**Operator**

(Operator Instructions) Phil Gibbs, KeyBanc.

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**Phil Gibbs** - *KeyBanc Capital Markets - Analyst*

Hey, good morning. Gregg, I had a question just on the daily demand momentum through the third quarter and then what you are seeing here early in the fourth quarter. How would you characterize that intra-quarter trend last quarter and then what you're seeing in October?

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

Well, Phil, it was softer in the third quarter than frankly any of us thought. We recognize the fact that the Fourth of July holidays and all that, but we thought we'd see some recovery, normally we do in August and, frankly, that did not happen. September normally recovers a little bit more on an average daily sales basis than August does.

That didn't materialize. So we guided, I think, 1% to 3% down in tons sold compared to second quarter and ended up close to 5%. That was disappointing.

We have not so far seen a recovery, which is why our guide of $0.65 to $0.75 may be somewhat disappointing to some people but it's realistic as far as we're concerned given the fact that we are projecting about a 7% decline in our tons sold in the fourth quarter compared to the third quarter which was down 9% compared to the second quarter. So one thing about Reliance that you will always know is we tell it like it is and we don't sugarcoat anything.

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

And we have read a lot of the headlines this morning by folks out there about the disappointing Q4, which certainly the EPS numbers are. But I think to Gregg's point, being down 5% to 7% fourth quarter is historically down 5% to 7% or even 5% to 10% in volume last year, in 2015 our fourth quarter tons were down 7% compared to the third quarter. We had not fallen as much in the third quarter, so to us the demand trend being down the way it is is not really out of the ordinary.

We wish it was stronger. Our average selling price Q4 last year to Q3 was down 4.5%. We are guiding down 1% to 3% last year.

And we've tried I think over the years, and I think Phil you get it, but we really try and make people understand how important a shipping day is in the service center business. And we have less shipping days in the fourth quarter that even if demand stays relatively steady we are going to ship fewer tons because our customers are closed.

And so we expect to still operate very strong in the fourth quarter, still hitting our gross profit margin, turning our inventory, doing all the things that we do well. But just given the market trends that are out there, our earnings are going to be down a bit and our fourth-quarter earnings per share always fall off significantly from last year or from the third quarter to the fourth quarter. And this year, although seen as disappointing, is really not that much different than prior-year trends.

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**Phil Gibbs** - *KeyBanc Capital Markets - Analyst*

I appreciate that. And, Karla, I might have missed it, but did you give any color and what you anticipate the fourth-quarter gross profit margins are going to do? Does it imply that they are going to be down a little bit with pricing?

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

Yes, our expectation, we talked a little bit in the second quarter when we hit the 31.1% gross profit margin that there was some impact in there from the rising prices that we didn't think would be sustainable. We thought our first-quarter gross profit margin levels that were 29.4% were something that could be sustainable in the current environment.

The environment has gotten a little worse but we did come in above that in Q3. And so I think from Q4 just given the market fundamentals we expect there may be a little lessening of the gross profit margin in the fourth quarter from the third quarter, but not too significantly.

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**Phil Gibbs** - *KeyBanc Capital Markets - Analyst*

Okay. And I just have one operational question and I will jump off. I appreciate this.

Jim, the alloy shipments were up in the third quarter versus the second quarter. That's something that we were expecting. Was that based on some of the comments that you are making on the energy side in terms of finally starting to see a little bit of pull-through in the oil patch?

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

Those are projects a couple of really big orders up in Canada that we decided to get involved with to help with our inventory turns. Nothing concrete. I wish I could tell you yes.

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

And that's the normal seasonality in the Canadian market, too.

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

The ground has to freeze up there to get where they need to get.

**Phil Gibbs** - *KeyBanc Capital Markets - Analyst*

All right. Thanks so much. Have a great one.

**Operator**

(Operator Instructions) Timna Tanners, Bank of America Merrill Lynch.

**Timna Tanners** - *BofA Merrill Lynch - Analyst*

Yes, good morning guys. So clearly fourth quarter we do, it seems like often, forget the sequential declines are consistent as you point out, but I think it's still be third quarter that surprised us. So sorry for harping on it again, but I was wondering if you wouldn't mind going into a little bit more color on what you are seeing in terms of your auto customer, reminding us how much exposure you have there?

I know it's relatively small, and also we are hearing some slowness there. Is that something you are hearing? And then on your aerospace forecasts and the way were thinking about that market, are you factoring in downside risk to build rates?

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

Well, to address the automotive we are doing very well in automotive. We've invested more this year. We actually brought on another line I think in, what, the end of the second quarter?

So we have not seen any slowdown except for the fact that July there's some maintenance shutdowns at some of the automakers but that's normal. So we are doing well in auto and we foresee that to continue.

Anything in the 17 million build rate is extremely strong. So we are not complaining about our investments or the profitability of the companies that we have that are servicing the automotive business.

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

We also brought our new plant in Mexico came online in July, doing quite well.

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

Yes, that's a good point, Jim. I forgot about that.

We opened up a facility in Monterrey, Mexico servicing the automotive industry and that plant opened up July 1. We moved some business that we were doing about 80 miles away, in Ramos, down to that plant. We expect that plant to be doing very well sometime in the first half of 2017.

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

And remember even in auto, even if build rates were to level off, we've been and through our investments and our position to process aluminum we've been picking up a lot of new business, additional tolling business because we can process the aluminum.

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**Timna Tanners** - *BofA Merrill Lynch - Analyst*

Okay. That's fair.

Then I wanted to ask a question I think I've asked before, but it's still kind of a hot topic I think with the prevalence of a lot of the mini-mills contained to invest in fabricating and making a focus on fabricating a lot more of their own metal. Are you seeing them impinge on any of your potential acquisitions or potential -- are they starting to compete with you a little bit more? Are there still plenty of options for you to enter into more fabricating options as you've discussed further M&A opportunities?

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

No, they haven't infringed in our space really. Nucor just recently bought the tubing mill, Independence, and that's probably a good thing for the industry. Hopefully it's a good thing for Nucor.

Obviously, we wish them well. But as far as them getting into the service center industry any of the mills we haven't seen it. We don't anticipate to see it, it's not getting in the way of our M&A outlook, so as far as we're concerned it's a non-event.

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**Timna Tanners** - *BofA Merrill Lynch - Analyst*

Okay great. Thank you.

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**Operator**

Aldo Mazzaferro, Macquarie.

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**Aldo Mazzaferro** - *Macquarie Research - Analyst*

Hey, Karla, I just had a quick question on the balance sheet. The credit line and the term loan that you took that you put in place September 30, I take it that's not on the balance sheet at the date of September 30, correct?

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

So we did close it at September 30. So we did refinancing then.

So, yes, it's just a switch, so you would see the switch from really you are not going to see anything on the balance sheet because it's all in long-term debt. It's just a little more is allocated to the term loan now instead of the revolving credit facility but it shows up on the same lines in the balance sheet.

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**Aldo Mazzaferro** - *Macquarie Research - Analyst*

I got it. So could you briefly tell us what the strategy was behind refinancing there?

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

Yes, so we had the $350 million worth of senior notes that mature in November, and so we looked at the market to either refinance or to pay down that $350 million through a new bond issue or on the bank line. The bank market does have a lot of capacity now. The rates on the bank line are certainly more attractive and more accretive to our earnings per share than a new bond issue would have been, so really it was that driving higher earnings and having the availability within the bank market that allowed us to do it.

We also are revolving credit line and our existing term loan would have been maturing. It would become current at the beginning of next year in April. So we would have been out in the bank market at that time anyway so that it didn't become current.

So the timing worked out. And, again, the main driver again was just for more attractive pricing to drive higher earnings per share.

**Aldo Mazzaferro** - *Macquarie Research - Analyst*

At this time are you expecting any sizable acquisition transactions to happen in the industry over the next 12 months? Sizable, I mean something that would move the needle (multiple speakers)

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

I think the acquisition pipeline continues to be pretty active. What we are seeing are a lot of smaller acquisitions, some that make sense that are attractive to us, a lot there are a little outside our wheelhouse that we're not that interested in or they don't meet the financial criteria that we look for.

So we are still looking at a lot of transactions. We haven't been seeing a lot of the larger transactions but some of these smaller transactions are extremely strong performers. It's on a smaller base but they drive very high returns.

So those continue to be attractive to us. But to the extent we see any larger opportunities we will look at that. There could be various reasons, market reasons that some of the larger companies might see it as a catalyst of a reason they need to sell, but we haven't been seeing or hearing anything about that currently.

**Aldo Mazzaferro** - *Macquarie Research - Analyst*

All right, thank you.

**Operator**

John Tumazos, John Tumazos Very Independent Research.

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

Thank you very much for a very informative call. In terms of the impairment charges and volume declines generally, would you characterize it as many small customers and end markets being a little bit weak collectively or that there is more specific issues like energy in Texas being weak or Boeing squeezing the aerospace supply chain or something that's more specific to a region or end market in particular?

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

It would be more associated with the oil and gas in the southern region of the country. So Texas (multiple speakers), the impairment charge. So companies that we have several companies that we are basically closing are -- and their main focus has been the oil and natural gas, and it's just dried up tremendously for them and has been for a while and we don't see that turning around with these particular companies anytime soon.

So some of that business we're actually going to transfer to other energy-related businesses that we have basically in the Houston Louisiana area. So we are not going to lose the entire amount of business, we are just going to reduce our exposure to that, cut our expenses back as best we possibly can. But everything, John, related to those that write-down or not is energy-related.

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

And it's all, they are all small locations. Like Gregg said they are getting -- we can still support those markets. And so I think the impairment is not what is driving our guide of demand being down 5% to 7% in the fourth quarter.

That's more normal seasonality and just in general, as Gregg said, demand being weaker because of the uncertainty out there. But that's really pretty much across all markets. It's not specific to any in particular.

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

If I could follow up by asking a question on shapes and I'm just looking at Nucor's financials because they came out this, morning, too. In the September quarter versus the March quarter six months earlier, Nucor's prices were $195 higher for sheet, but they were $5 lower for large structurals and only $28 higher for fabricated steel and it would appear as though they made more money in sheet and plate and made less money in big beams and fabricated products. Are you seeing that certain shapes are more profitable and other end markets are weaker construction or whatnot?

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

As far as we are concerned there was a drop on structurals of $60 a ton last month. So that was a correction that probably needed to be made because there was a lot of discounting being had from suppliers to customers like ourselves that were below the book prices. So the book prices were in jeopardy, so I think their $60 a ton drop was appropriate.

As far as profitability is concerned, at Reliance all of our, basically all of our products we've been driving gross profit margins like unbelievable the last, in particular the last couple of years. So our margins basically on all the products that we have are a little bit better than they were a year ago and two years ago.

So there hasn't been any major change, at least in our business, other than the fact that we've put a lot more emphasis on processing and providing our customers with a more finished product and charging them for it. So I hope that answers your question.

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

Thank you very much.

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**Operator**

Mr. Mollins it appears we have no further questions at this time. I would now like to turn the floor back over to you for closing comments.

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

Thank you very much. Thanks again for your support and for participating in today's call. We would like to remind everyone that in mid-November we will be in New York City presenting at Barclays Industrial Distribution Forum and we will be there again in early December participating in the Cowen and Company Energy & Natural Resources Conference.

We hope to see many of you there and we hope you have a great day. Thanks for joining us.

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**Operator**

Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.

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