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MANAGEMENT DISCUSSION SECTION

Operator: Greeting and welcome to the Reliance Steel & Aluminum Company's Fourth Quarter and Full Year 2016 Earnings Conference Call. At this time, all participants are in a listen-only mode. Our question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Ms. Brenda Miyamoto, Investor Relations for Reliance Steel & Aluminum. Thank you. You may begin.

Brenda Sumiye Miyamoto
VP-Corporate Initiatives & Head-Investor Relations, Reliance Steel & Aluminum Co.

Thank you, operator. Good morning. And thanks to all of you for joining our conference call to discuss our fourth 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 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 J. Mollins

President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

Good morning, everyone, and thank you for joining us today. Operationally, 2016 was a terrific year for Reliance as our focus on maximizing gross profit margin resulted in our first-ever annual gross profit margin above 30%. Although somewhat improved from 2015, the macro environment for our industry continue to be challenging with overall lower demand levels and pricing volatility, resulting in the sales decline of $737 million in 2016 compared to 2015, due mostly to lower metal pricing. However, the expansion of our FIFO gross profit margin to 29.8% for the 2016 year, a 380 basis point improvement over 26% in 2015, added $328 million more gross profit dollars, generally offsetting the reduction to our pre-tax income from our lower sales levels.

We believe our ability to increase our gross profit margin was made possible by significant investments we have made in our value-added processing equipment to provide our customers with superior service and quality in combination with our pricing discipline and effective inventory management.

Maximizing gross profit margin has always been a priority at Reliance, but in late 2014 we placed a renewed focus on properly pricing the value we provide to our customers, as well as being selective with the orders we fulfill, which is easier to do when your inventories are in good shape. This focus and effort produced six consecutive quarters of FIFO gross profit margin improvement and a 600 basis point improvement from 25.1% in the fourth quarter of 2014 to a peak of 31.1% in the second quarter of 2016.

While rising metal prices supported our peak gross profit level in the second quarter of 2016, the fundamentals that I mentioned earlier, increased value-added processing, pricing discipline and inventory management have lifted our gross profit margin expectations to a new level. Assuming no significant changes in market conditions, we believe that we can sustain a reported LIFO gross profit margin within the range of 27% to 29%. Our 2016 inventory turn rate was 4.5 times based on tons, nearing our companywide target of 4.7 times. We believe an efficient inventory position benefits our gross profit margin, in that it enables us to focus on higher margin business. We experienced significant metal pricing volatility throughout 2016, especially for carbon steel products.

Based on the CRU published pricing index, hot-rolled coil prices increased by $242 per ton in the first half of the year, declined by $151 per ton in the July to November period, and an increase by $140 per ton from December through February. In spite of these dramatic pricing swings, we were able to manage through this volatility, maintaining our FIFO gross profit margin at 29% or better throughout 2016. However, given our product mix, we ended the year with our 2016 average selling price down 6.8% compared to 2015.

Metal pricing in 2016 was positively supported by trade cases filed by U.S. producers on various products, along with production capacity discipline and price increases in raw materials. The trade cases have helped stabilize import levels and lower the spreads, as metal prices overseas had increased to a level where it's not all that advantageous to buy foreign material. Although, metal pricing weakened in the third quarter, the environment recovered at multiple price increases were announced by mills throughout the fourth quarter of 2016 and that's continued into 2017.

Our average selling price in the fourth quarter of 2016 was basically flat with the third quarter, which is better than our expectation of down 1% to 3%. As we begin 2017 there is some pressure on certain raw material cost. However, we anticipate a positive pricing environment in the first quarter of 2017 with current pricing levels holding and possibly improving.

Customer demand levels have remained generally healthy, in line with the difficult seasonal slowdown, our fourth quarter tons sold declined by 5.6% from the third quarter, consistent with our expectation of down 5% to 7%. For the full year of 2016, our same-store tons sold declined by only 2.7% and once again outperformed the MSCI industry average shipments which were down 6.2%.

We believe we've been able to continue growing our market share through our unique diversification strategy along with our decentralized operating structure, investments in value-added process and equipment, and focus on customer service, including small order sizes and just-in-time delivery. While overall demand for metal products was not as strong as we expected when we entered 2016, customer sentiment has improved and we anticipate improving demand level as we move through 2017.

We believe our exposure to a broad array of products and end markets helps mitigate declines in any single market. The automotive and aerospace markets in particular have continued to be very strong for us. We have also performed well, servicing the non-residential construction market as it continues its slow recovery, and we are encouraged by early signs of life in the energy market.

In regard to energy, the general consensus from our customer base throughout the country is more positive today than it was 90 days ago. We've been seeing improved quoting activity and order flows, though order sizes have been much smaller. As the downturn in oil prices and drilling activity began toward the end of 2014, we proactively addressed the declines in this market through facility closures and asset write-downs at certain of our energy-related businesses and believe we are well-positioned to participate in any recovery. With incremental spending in both infrastructure and energy on the horizon, we expect overall metals demand in the U.S. to improve, which ultimately benefits Reliance.

Turning to M&A. In 2016, we successfully completed three acquisitions, increasing our total to 62 quality companies acquired since our 1994 IPO. Since joining the Reliance family, each of these three acquisitions has performed in line with our expectations. These companies fit our acquisition strategy of growth and specialty and high margin products and services and all were immediately accretive to our earnings.

The acquisition Tubular Steel strengthen our foothold in the energy end market. Although current activity levels are lower than normal in energy, we are confident in this market's long-term strength and Tubular Steel's ability to benefit during the recovery. Best Manufacturing increased our high margin value added processing capabilities and Alaska Steel broadened our geographic reach with our first entry into the Alaskan market in diverse industries, including infrastructure and energy.

Looking ahead in 2017, the acquisition pipeline remains active and our two-pronged growth strategy remains unchanged. We will continue to focus on organic investments, primarily in cutting edge, value added processing equipment that will enhance our earnings. And we are always interested in and continuously evaluating well run companies that complement our diversification strategy and meet our stringent acquisition criteria.

Our strong cash flow generation has enabled us to grow both organically and through acquisitions, while simultaneously returning cash to our stockholders through quarterly dividends and opportunistic share repurchases. We increased our regular quarterly cash dividend to $0.45 per share effective in the first quarter of 2017, a 6% increase. We have paid dividends for 57 consecutive years and this is our 24th increase since our 1994 IPO.

In summary, 2016 was a solid year for Reliance. We could not be more pleased with the strong operational performance by our managers in the field. Their strict pricing discipline and diligent expense and inventory management enabled Reliance to thrive despite challenging market conditions. We look forward to 2017, which we expect will feature a renewed enthusiasm for infrastructure and equipment spending, as well as improvement in the energy market and we believe that Reliance is very well positioned to capitalize on these opportunities.

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

James Donald Hoffman

Chief Operating Officer & Executive Vice President, Reliance Steel & Aluminum Co.

Thanks, Gregg, and good morning, everyone. First off, I would like to recognize our folks in the field that contributed to our many successes in 2016 and particularly our enhanced gross profit margin. I'm very proud of these achievements.

Now, I'll 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 will 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 U.S. and Mexico remains very strong at current production rates. The increased usage of aluminum in automotive has been the primary driver behind our growth activities. Given our significant capital investment, we expect to further increase our volume of aluminum processed in 2017, surpassing our record levels obtained in 2016.

In addition to investments in processing equipment, we've been expanding our facilities to support the higher levels of automotive demand for both carbon and aluminum processing. Our new facility in Monterrey, Mexico commenced operations in July of 2016 to support automotive activity in that area is already running at close to capacity, in line with our expectations. In regards to our new U.S. facility in Kentucky, construction remains on schedule and we expect that facility will become operational in mid-2017. Our Kentucky facilities will be used to support both aluminum and steel processing in that region. We will continue to strategically add incremental capacity to drive higher levels of profitability in our toll processing operations.

Fourth quarter demand in heavy industry which includes railcar, truck trailer, shipbuilding, barge manufacturing, tank manufacturing and wind and transmission towers was comparable with levels experienced in the third quarter of 2016, though still down on a year-over-year basis. As a reminder, heavy industry include sales to agriculture equipment OEMs, which has been a weaker area of the market. That said, our heavy industry exposure is mostly to small and mid-size agricultural equipment rather than the larger equipment, which is experiencing greater weakness. Also of note, we are experiencing improved demand trends in the road construction equipment market due to the five year infrastructure bill, which was passed in December of 2015.

Demand in non-residential construction market continues to experience steady upward growth. We expect improvements in our tons shipped will continue in 2017 at a slow but steady pace, the volume is still far below peak levels. We're continuing to invest in processing equipment for the businesses that sell into non-residential construction to ensure we are providing the highest possible level of service to our customers and we are positioned to absorb increased volumes in our existing footprint and cost structure as this end market improves. In addition, the prospect of adding additional spending on our domestic infrastructure bodes very well for Reliance.

Demand for energy, which is mainly oil and natural gas improved somewhat versus the prior quarter. Though drilling activity levels remain low, rig counts continue to increase throughout the fourth quarter and into January. In fact, for the first time in about a year, rig counts in January were up year-over-year, though still far below peak levels.

As Gregg mentioned, quoting and overall activity has been on the rise, which has created a much more positive environment for our customers in our energy businesses. These encouraging signs of new activity leads us to believe that the bottom of this downturn is behind us. Because of the proactive measures we took to right size our energy businesses during the downturn, we fell positioned to support new activity as drilling and rig counts continue to improve.

Pricing for carbon steel products, especially hot-rolled coal improved significantly in the fourth quarter of 2016, with multiple mill price increases announced throughout the quarter. Increased raw material pricing especially scrap, as well as multiple carbon steel trade cases filed in the U.S. throughout 2016 helped support the domestic pricing trends. Increases were also announced on plate and long products which represents our largest product exposure. Although there is potential for scrap to decline, we believe increased customer demand and fewer imports in the first quarter should support current pricing level.

And lastly, for alloy products, the majority of which are sold into the energy end market, our volumes continued to decline in 2016, giving our expectation of the improved demand for these product we anticipate flat to higher pricing.

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

William K. Sales

Executive Vice President-Operations, Reliance Steel & Aluminum Co.

Thanks, Jim. Good morning, everyone. Let me also start by congratulating our folks in the field on an outstanding operational performance in 2016, especially in regard to our gross profit margin improvement in a difficult pricing environment. Keep up the great work. I will now review pricing and demand for our aluminum and stainless steel products. I'll also discuss some of the key industry trends in the markets for these products.

I'll begin with aerospace which continues to be a very strong end market for Reliance. We consider mill lead times, build rates and backlogs to be a key indicators of the health of the aerospace market. Today, lead times continue to be about seven to nine weeks for aluminum aerospace plate. Build rates should improve modestly in 2017, led by single-aisle planes. And we expect build rates to continue to increase through 2018 and 2019. The backlog for orders of commercial planes remains very healthy. Overall demand in the aerospace market continues to be solid, especially for aluminum plate where we experienced healthy volume growth in 2016. Based on these trends, our outlook for the aerospace market remains positive.

Of note, 2017 marks the beginning of our involvement with the five-year $350 million Joint Strike Fighter program, strengthening our already strong position in the aerospace and defense markets. In addition to the JSF program, we are seeing increased activity from many of our defense customers as spending on defense ramps up.

I'm also pleased to announce that we're in the process of expanding our aerospace presence to India through our All Metal Services subsidiary based in the UK that we acquired in 2014. This expansion represents our first entry into India and we are excited to be able to support our aerospace customers on a more global basis. We expect the business to become operational by the end of the third quarter of 2017.

Turning now to pricing trends. 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. Prices for heat-treated aluminum plate have remained fairly stable with the prior quarter. Common alloy aluminum conversion pricing has remained fairly stable, as did our volume levels in 2016. Most of our common alloy aluminum products are sold to sheet metal fabricators that support a variety of end markets. Pricing of common alloy aluminum sheet follows the price of ingot. We expect some modest improvement as the Midwest spot price trends up slightly.

Lastly, demand for our stainless steel flat products, which are primarily sold into the kitchen equipment, appliance and construction end markets remained solid. Pricing has continued to improve as a result of that solid demand with both the base price and surcharge increasing in January.

Thank you for your time and attention today. With that, I'll now turn the call over to Karla to review our fourth quarter and 2016 financial results. Karla?

Karla R. Lewis

Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.

Thanks, Bill, and good morning, everyone. Our net sales in the fourth quarter of 2016 were $2.1 billion, up 1.7% from the fourth quarter of 2015 with our tons sold down 1.1% and our average selling price per ton sold up 2.7%, compared to the third quarter of 2016, our net sales were down 5.7% with our tons sold down 5.6% and pricing was flat. The decline in tons sold compared to the third quarter was due to normal seasonal factors, including fewer shipping days as a result of holiday-related customer closures and was in line with our guidance of down 5% to 7%.

We had expected our average selling price to decline 1% to 3% in the fourth quarter as compared to the third quarter. However, due to the multiple mill price increases during the fourth quarter, our average selling priced held in higher than we had anticipated. We were very pleased with our ability to sustain our strong gross profit margin throughout 2016.

Our FIFO gross profit margin of 29.0% in the fourth quarter of 2016 was up 230 basis points from 26.7% in the fourth quarter of 2015. Although, metal pricing trends were improving in the fourth quarter of 2016, our year-end cost of inventory on hand was lower than at the end of the 2015 year, resulting in a LIFO inventory valuation adjustment of a credit or income of $35 million for the full year 2016 compared to income of $117 million in 2015.

At December 31, 2016, our LIFO reserve was a debit balance of $52 million. Because our LIFO inventory cost on hand at December 31, 2016 was higher than current replacement cost, we recorded a lower of cost or market reserve of $42 million. In our fourth quarter guidance, we estimated a pre-tax LIFO inventory valuation adjustment of $15 million of income for the 2016 year anticipating $3.8 million of income in the fourth quarter. The actual adjustment recorded in the fourth quarter of 2016 was income of $16.2 million, resulting in $0.11 more earnings per share than we had estimated.

At this time, we anticipate that metal prices will increase in 2017 compared to our inventory cost on hand at the end of 2016. If prices increase, we anticipate a LIFO charge or expense in 2017 which could be at least partially offset by adjustments to our lower of cost or market reserve. As in prior years, we will update our expectations quarterly based upon our inventory costs and general metal pricing trends.

Metal pricing has a significant impact on our sales and earnings levels. For the full year of 2016, our sales of $8.6 billion were down 7.9% from 2015. Our average selling price for 2016 was down 6.8% or $107 per ton from our average selling price in 2015, reducing our sales by about $624 million solely due to lower metal prices. And this also reduces our gross profit dollars, most of which would also reduce our operating and pre-tax profits.

However, because we were able to increase our FIFO gross profit margin by 380 basis points to 29.8% in 2016, we earned $328 million more gross profit dollars than we would have earned at our full year 2015 FIFO gross profit margin of 26.0%. In other words, compared to our full year 2015 financial results, in 2016, we generated more gross profit dollars on $737 million of less sales, demonstrating the importance and positive impact of our higher gross profit margin.

Our effective income tax rate for the full year of 2016 was 28.0% compared to 31.1% in 2015. Our lower rate in 2016 was mainly due to the favorable resolution of certain tax matters in the first quarter of 2016. And we currently expect that our full year 2017 effective income tax rate will be approximately 31.5%. Net income attributable to Reliance for the fourth quarter of 2016 was $61.7 million or $0.84 per diluted share. Our non-GAAP diluted earnings per share were $0.84 in the fourth quarter of 2016 compared to $0.87 in the fourth quarter of 2015 and $1.25 in the third quarter of 2016.

For the full year of 2016, our earnings per share were $4.16, the same as in 2015, despite our low sales levels, resulting mainly from lower metal pricing, which was offset by our improved gross profit margin, effective expense management and lower tax rate. Please refer to our earnings release issued earlier today for a reconciliation of our non-GAAP adjustments.

Turning to our balance sheet and cash flow. Because of our effective working capital management and strong gross profit margin, we generated $238.9 million of cash from operation during the fourth quarter, resulting in $626.5 million for the full year of 2016. At December 31, 2016 our total debt outstanding was $1.9 billion consistent with December 31, 2015 and our net debt to total capital ratio was 30.3%. At December 31, 2016, we had just under $900 million available on our $1.5 billion revolving credit facility.

Our strong cash from operation enabled us to both grow the company and return value to our stockholders. In addition to funding the three acquisitions we completed in 2016 for a total of $348.7 million, we use our cash from operations to fund $154.9 million of capital expenditures and to pay quarterly cash dividends totaling $120.4 million to our valued stockholders.

Looking ahead to 2017, we expect to continue executing on our balanced capital allocation strategy that includes growth through both acquisitions and organic investments, as well as stockholder return activities, including payments of our increased quarterly dividend and opportunistic repurchases of our common stock. Our 2017 capital expenditure budget is $200 million, the majority of which will be used to support our ongoing organic growth initiatives, including opening new facilities and increasing our value added processing capabilities.

Turning to our outlook, given the positive sentiment for both metal pricing and demand in early 2017, we are optimistic in regard to those business activity levels and metal pricing. We estimate tons sold will be up 8% to 10% in the first quarter of 2017 compared to the fourth quarter of 2016 due to normal seasonal factors as well as our January shipment levels exceeding year ago levels.

Metal pricing continues to trend higher for almost all of the products we sell. Therefore, we expect our average selling price in the first quarter of 2017 will be up 2% to 4% from the fourth quarter of 2016. As a result, we currently expect earnings per diluted share to be in the range of $1.25 to $1.35 for the first quarter of 2017.

In closing, we continue to be very pleased with our overall financial performance, and I'd like to thank all of our employees for their outstanding execution in 2016 that contributed to our strong performance. We look forward to continued success in 2017.

That concludes our prepared remarks. Thank you for your attention. And at this time, we would like to open the call up to questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Timna Tanners with Bank of America Merrill Lynch. Please proceed with your question.

Timna Beth Tanners
Analyst, Bank of America Merrill Lynch
Q

Hey good morning, everyone.

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.
A

Hi.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.
A

Good morning.

Timna Beth Tanners
Analyst, Bank of America Merrill Lynch
Q

Just a couple of questions. One was on defense and you spoke positively about, I was curious how much of your total end market is defense? And then can you give a little bit more clarity around your comments on the energy market uptick, obviously the rig count is moving up sharply higher from a really low level? But there's a lot of equipment on the ground and pipes that still needs to get used or scrapped, I suppose. Can you give us a little bit more color on those two end markets?

William K. Sales
Executive Vice President-Operations, Reliance Steel & Aluminum Co.
A

Timna, it's Bill. Hey, I'll jump on to the fifth question. We have aerospace and defense really grouped together and that represent roughly 10% to 12% of our total business. Defense obviously is a smaller component of that, but we are seeing definitely increased activity.

James Donald Hoffman
Chief Operating Officer & Executive Vice President, Reliance Steel & Aluminum Co.
A

And Timna, this is Jim. How are you?

Timna Beth Tanners
Analyst, Bank of America Merrill Lynch

Q

Hello.

James Donald Hoffman
Chief Operating Officer & Executive Vice President, Reliance Steel & Aluminum Co.

A

Good. Hey, on the energy question, I think I understood. We are not into line pipe at all. So, we wouldn't have anything to do with that. Most of what we do in energy is in the completion end and maintenance and tools that are basically above the wellhead. So, the activity we're seeing just simply more activity, it's more quoting smaller orders, however more orders. So, the excessive pipeline around really doesn't bother us at all.

Timna Beth Tanners
Analyst, Bank of America Merrill Lynch

Q

Well, there is an excessive completions pressure pumping equipment line around too, so I guess it was just a more general comment. So I was just wondering if you can quantify like may be the uptick that you're anticipating from very low levels?

James Donald Hoffman
Chief Operating Officer & Executive Vice President, Reliance Steel & Aluminum Co.

A

I'm not sure how we could do that other than it feels better. How's that?

Timna Beth Tanners
Analyst, Bank of America Merrill Lynch

Q

Fair enough. That's a tough question. All right. So also wanted to ask you on the cost side. What we're seeing in some of the companies that we follow is that as conditions improve, it's tough to keep a lid on cost. But I know that you've done so really well into 2016. You talked confidently. I think Gregg said that 27%, 29% gross margins were sustainable in the future and your average was 29.7% in 2016. And I apologize if I'm mixing FIFO versus LIFO here. But is that a conservative number now or are there some costs that are going to creep back in this environment that we might be missing?

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

No, I don't think it's a cost issue. I think it's just our pricing discipline that we really got focused on even more so than in the past in the 2015-2016 year has put us into that 27% to 29% range. Is it conservative? No, I don't think it's conservative. I think it's actually pretty accurate. Now, that can be fluctuated with market conditions going up or down economically or with pricing, but overall we've hesitated the answer to the question whether or not it was sustainable or not till we saw about eight quarters of consistent increases, till we hit a level at that 29% range. So, we're much more confident today than we were two years ago about being able to sustain 27% to 29% and it's really not a cost-effective driven matrix.

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.

A

Yeah. And just Timna as a reminder, our cost of sales is only our material price. So, we're not having labor overhead up there. So, our gross profit margin is really based upon our spread between our selling price and our metal cost, so, just keep that in mind. And also our 27% to 29% range is kind of a more long-term, not a quarterly range, more of an annual range. And it is on a LIFO basis. So, to the extent, prices might be going up, we would anticipate potentially some LIFO expense to bring the margin down a bit.

Timna Beth Tanners
Analyst, Bank of America Merrill Lynch

Q

No. That makes sense. I guess to ask it a little more specifically, then I'll hand off. Is there any reason to expect any change in your cost going forward? So, the point being that you did have overhead cost rise, but not crazy into 2016. So, should we assume that it kind of keeps pace with what we've seen on that line item? And then, you had almost 30% gross profit margins in 2016 and I understand it's a long-term view, but is there something that gives you that 27% to 29% conviction into 2017 that would cause margins to lighten up a bit from where they've been?

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

I don't think there's any concern. I do believe that I have to say that we're going to be sustainable at 30% is probably a little bit of a reach, especially when we're talking about LIFO, because as Karla pointed out in her presentation that if prices continue to go up, the likelihood of an expense in LIFO is likely. So, if I were you, I'd stick to that 27% to 29%. I think that's a pretty good guide.

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.

A

Yeah. And as you know, Timna, we don't want to put out ranges that we're not confident that we can stay within. And in the second quarter of 2016, we were up to 31.1% FIFO gross profit margin, but that was in the period of rising prices. And Reliance, historically, you've seen us when mill make price increase announcements, we're typically able to expand our gross profit margin until we get the higher cost metal in our inventory. So, we would expect that to continue. So, on a quarterly basis, you might see some bumps given our ability to take advantage of the market condition.

Timna Beth Tanners
Analyst, Bank of America Merrill Lynch

Q

Okay. That makes sense. Thanks again.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

Okay. Thank you.

Operator: Thank you. Our next question comes from the line of Phil Gibbs with KeyBanc Capital Markets. Please proceed with your question.

Philip N. Gibbs
Analyst, KeyBanc Capital Markets, Inc.

Q

Hi, Gregg, Karla, Jim, Bill, good morning.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

Good morning, Phil.

Philip N. Gibbs
Analyst, KeyBanc Capital Markets, Inc.
Q

A question on just the business trends moving into February, January was, at least per the MSCI data, fairly strong in terms of how we started the year. How should we think about the rest of the quarter playing out in terms of what you're seeing on the ground?

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.
A

Well, we were pleased with our results in January, and February continues to be at a similar pace. So, we're happy with that. Could things change? Yeah, they can always change. That's the business we're in. But so far so good and we're hopeful. I think our guidance from $1.25 to $1.35 in the first quarter reflects that.

Philip N. Gibbs
Analyst, KeyBanc Capital Markets, Inc.
Q

Okay. And then on general infrastructure expectations, what are your customers telling you right now in terms of what to expect? What do they expect in terms of momentum and timing right now? Because obviously, the market wants to get out of itself and what this all could mean, but I think we're just trying to understand what are the real conversations taking place out there?

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.
A

Jim?

James Donald Hoffman
Chief Operating Officer & Executive Vice President, Reliance Steel & Aluminum Co.
A

I think everybody is optimistic. It's just a matter of the timing. A lot of things are happening in Washington right now. It's all really sounds great for the steel business in Reliance. I think everybody anticipates spending, just a matter of when does it come, does it come in 2017, that'd be great. I think that if you took a poll, most would say, it'd be more into 2018, because of just the length of the time to plan these projects from what have you. But overall, it sounds very optimistic to us.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.
A

Yeah, talking to our people in the field, Phil, okay, the customer sentiment as well as our own is much more positive. Have we seen projects that would support that all of the sudden the spending is actually put in place, at this point in time, the answer is no, we have not. So, we would anticipate the mills would probably see that first. And normally in an up cycle in the infrastructure, in non-residential construction business, the mills do see it first because of project tons that are given to them and then we follow probably six months after the tract.

But we're doing well, I have to tell you this, our [indiscernible] (40:12) cost, we attacked our cost after 2009. We're extremely competitive on the cost side of our business. Our people that are in – the companies that are actually in the non-residential infrastructure business are doing extremely well, much better than our company average. So, we're not complaining about the activity in non-res and infrastructure right now as we speak, but we anticipate that it is going to get better and to Jim's point, it's just a matter of when.

Philip N. Gibbs
Analyst, KeyBanc Capital Markets, Inc.
Q

Okay. I appreciate that. And Karla, on the Q1 range $1.25 to $1.35, relative to that 29% FIFO gross profit margin that you just did in the fourth quarter, what is the embedded expectation in Q1 for FIFO gross profit margins? And then also LIFO, I know you just spoke of – well, as prices go up, we'd expect to see something. But what's actually have embedded in the thought process?

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.
A

Yeah. So, first off, from kind of the FIFO gross profit margin range, as I just commented, when there are no price increases announced, we typically get a little bump before we got the higher cost inventory in. So, we did have – our inventory cost at the end of 2016 was lower than current cost, so I would expect that we'll get a little bit of that bump, a little bit of that expansion in Q1, but generally in line towards the top of that range. And then from a LIFO standpoint, currently our Q1 guidance has kind of no LIFO expense in it, even though we do anticipate prices will be higher, which would generate LIFO expense, we still have that $42 million lower of cost or market reserve that theoretically if prices go up, our reserves comes down. So any LIFO expense currently we would expect to be offset by a lowering of that reserve.

Philip N. Gibbs
Analyst, KeyBanc Capital Markets, Inc.
Q

Okay. That's helpful. And last question, and then I'll hop here. General industrial exposure for your company, I think most people know aerospace and auto and construction, but just in general, what's the industrial – kind of pure industrial exposure that you have? Thanks.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.
A

On the heavy equipments.

James Donald Hoffman
Chief Operating Officer & Executive Vice President, Reliance Steel & Aluminum Co.
A

Yeah. You're talking about – the one that you probably left out is heavy equipment. It's the same. Mining has been depressed for a long period of time. Ag is a big steel consumer. The larger units are the ones that have been really depressed recently for a lot of reasons, global demand. Our sweet spot is in that smaller up to mid-range kind of equipment. And it's okay, it's not as good as we'd like it, it's down from where it has been. We're projecting to be kind of flat for the rest of the year. However, we have seen some increase in road construction equipment, and then we believe that's because of the bill that was passed in December of 2015. People, who were manufacturing the equipment that tears up pavement and repaves them and what have you, we've seen a very nice uptick in those type of business.

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.
A

Yeah. And so, generally, we have somewhat limited visibility with where our product ends up because our customer base are a lot of small machine shops, fabricators, we don't always know where it's going. But the high level we've always kind of said, we think about a third of our business is non-res construction, which would include infrastructure and some related items, about a third, transportation which we would have the aerospace in there, railcar, truck trailers, those kinds of things. And then a third, general manufacturing, which includes all those things that Jim just talked about. Energy would fall in there. Semiconductor, we usually have a decent piece. So, there is just a lot of different stuff in that broad kind of general manufacturing, and a lot of it not big enough that we can specifically identify.

Philip N. Gibbs
Analyst, KeyBanc Capital Markets, Inc.

Q

No, it's really good color. I appreciate it. Thank you.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

Thank you.

Operator: Thank you. Our next question comes from the line of Aldo Mazzaferro with Macquarie. Please proceed with your question.

Aldo Mazzaferro
Analyst, Macquarie Capital (USA), Inc.

Q

Hi. Good morning. Hey, Karla, by the way those are great answers for the last two questions. I really appreciate that detail. The question that I have is, Gregg, when you were commenting on the market, I noticed that you mentioned three things that were driving or keeping prices up, the tariffs, the low output from the mills and then the raw materials increasing. The first two are supply related, the last one is cost inflation. I'm wondering – I know you say 8% to 10% growth in demand in the quarter. That seems a little stronger than your normal seasonal. Can you talk about what sectors – I mean I heard you mentioned energy, but is that the only area you're seeing kind of real demand improvement or where else would you be seeing it?

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

No, I think just in general, if you look across our company, throughout North America, basically, all the regions are a little busier now. Now, we had to come off of first quarter, I mean, off of fourth quarter to first quarter, normally we'll be somewhere around that 7% range.

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.

A

Yeah, we were just under 8% last year.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

Last year. Okay. So, on 8% to 10%, we just feel as though given that we were very pleased with our January results, we thought that the momentum was going to continue, which is why we gave the guidance that we did. But to answer your question, Aldo, it's really not specific to one particular industry, okay. It's really across the board and it's across the country, whether it be if you're on the East Coast, West Coast, the mid chapters, what have you, all of our companies are all simultaneously doing better than, frankly, we would have thought.

James Donald Hoffman
Chief Operating Officer & Executive Vice President, Reliance Steel & Aluminum Co.

A

And one other point, Aldo. We're hitting our stride now with our new plant, our automotive toll processing in Mexico and our new facility in Kentucky should be operational in the mid-2017s. We're looking forward to seeing how those two investments are going to pay out for us, we anticipate growing.

Aldo Mazzaferro
Analyst, Macquarie Capital (USA), Inc.

Q

Right. So, the reason I ask, because you say you're seeing February would be more or less like January. So, you're not seeing anything – were you hearing some chatter around shipments that weakened a little bit in February and sheet pricing or hot-rolled coil and the carbon market came down a little bit. But you're not seeing that as any kind of real change in trend then?

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

No, no, not really. I mean, we would anticipate – January was a little stronger than we thought, for February, it dropped-off a little bit, that's kind of our in guidance, okay. And March is generally a good demand month for us. So, no – we saw the hot-rolled coil prices weaken a little bit, but it wasn't anything to really concern us with. So, we're happy about the tariffs. We're happy about foreign material falling off a bit, we're happy to see certain Asian countries that are basically blocked out in some areas. So, all those are positive for us. And we're just going to continue to work on that gross profit margin, gave our guys – not only our guys in the field, but certainly Jim and his team for all the efforts that they put forth in that. So, we're seeing businesses has been a little bit better than we probably would have thought back in the fourth quarter for the first quarter. But we're pleased at what we see and we think it's going to continue.

Aldo Mazzaferro
Analyst, Macquarie Capital (USA), Inc.

Q

Great. Thank you very much. I'll get back in line for another one later.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

Okay. Thanks, Aldo.

Operator: Thank you. Our next question comes from the line of Seth Rosenfeld with Jefferies. Please proceed with your question.

Seth Rosenfeld
Analyst, Jefferies International Ltd.

Q

Good morning. It's a follow-up question on the last one. I'd be interesting in understanding your sense of what's happening from an apparent demand perspective with some of your end markets. I guess your January commentary after the MSCI release showed very strong volume growth in January. It would seem, I guess, a bit more robust we'd expect first time of the year. Can I just get a sense of whether or not you sense of any pre-buying activity amongst your customers due to the rising price environment and whether or not you think that you are seeing some rising inventories at the end market consumer as a result of that? Thank you.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

I think there's probably a little bit of that done. When you see price increases going up and you have a pretty good understanding about what's your first quarter needs are going to be, where you can buy a little bit heavy in January, why not. Okay. So, I would expect that there's some of that. But I don't think there's enough of that to cause any concern about our customers, end users being over inventory. There is just probably a point in time which is not unusual. It happens all the time when price increases go up, some of the companies, the end users, they buy ahead of it. But we don't see huge buys ahead of it that's going to impact our inventories and then future purchases. So, I think it's going to – it's nothing unusual. I think it's pretty much business as usual.

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.

A

Yeah. And I would say, the MSCI data a large portion of that is carbon flat-rolled related and that's the smaller part of our business. And Gregg was talking about the pre-buys, I think, we usually buy some of your larger OEMs and bigger volume customers. And remember at Reliance, we're doing 40% of our orders, they call us today, we deliver it tomorrow, $1,560 average order size. So, I think our demand trend stay a little more consistent because of our model than maybe some of the other companies reporting into MSCI, who have a different customer base and product mix.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

In particular, on the carbon side, we have very little as a percent of our total revenue stream in contracts with large OEMs, it's 95% spot, okay. So, what they need tomorrow, they buy today and we supply them with that. So, if you were a large contract participant like some service centers are, they probably saw more of that hedge than we did because of the customer base that we call on.

Seth Rosenfeld
Analyst, Jefferies International Ltd.

Q

Okay. That's very helpful. I guess, the second question, please, just on your outlook for the U.S. stainless market. If I remember correctly, you've been quite bullish on that particular product area since, I think last summer as we approached the limitation of new duties against China. Can you just talk a little about how that market has shifted over the last six months or so? Also, obviously there's a very big step-up in transaction prices in January, both base prices and of course alloy surcharges. Are those being fully accepted in the market? Or are you seeing any actual weakness in apparent demand because of that big step-up over the one or two months? Thank you.

William K. Sales
Executive Vice President-Operations, Reliance Steel & Aluminum Co.

A

Yeah, Seth, it's Bill, I'll address that. We have seen – I think the tariffs and the fact that China is pretty much out of the market, I think that's helped more stability on the pricing side. For us, most of our purchases are domestic, but there definitely has been more stability on pricing, I think that's one reason that the January base price increase happened and we think that increase is in place. And then we think also if you look at the fairly significant increase in the surcharge in January, we think that surcharge is in place. Looking out what we think will happen, February, the surcharge will be down a bit. We think March down slightly also. But based on what we believe will happen with nickel and chrome, we'll maybe start to see in April that surcharges might start to move back up slightly. But overall, I mean, our demand, we're pleased with our stainless demand and our stainless business. It's been one of our higher growth areas.

Seth Rosenfeld
Analyst, Jefferies International Ltd.

Q

Okay. And just one follow-up there, it's similar to the last question. Did you think you saw any kind of pre-buying back in December ahead of that expected big uptick in the alloy surcharge?

William K. Sales
Executive Vice President-Operations, Reliance Steel & Aluminum Co.

A

Yeah. We think there was a little bit of that. But, again, nothing that was super – real significant.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

And really for the same reasons why that we talked about with the carbon side [indiscernible] (53:55) customers that we're calling on and doing most business with are not contractual-related OEMs and they're small to mid-size job shops, sheet metal fabricators and what not. So, they're not as apt to do a larger buy. So, if we were doing business directly with appliance makers or kitchen equipment manufacturers that were massive, we probably saw more of that. But as it turned out – and that was a pretty significant increase and those decreases that we've seen recently are very minor, very, very minor.

Seth Rosenfeld
Analyst, Jefferies International Ltd.

Q

That's great. Thank you very much.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

Okay. Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Chris Olin with Rosenblatt Securities. Please proceed with your question.

Chris Olin
Analyst, Rosenblatt Securities, Inc.

Q

Hi. Thanks for taking my questions.

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.

A

Good morning.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

Sure. Good morning, Chris.

Chris Olin
Analyst, Rosenblatt Securities, Inc.

Q

I just wanted a quick follow-up question on the stainless steel market. Base prices, surcharges had been moving up I guess before the January price increase. And I was doing the math in terms of your realization for stainless, and it was up about 2% year-over-year. And I was just wondering if there's a mix issue in there or raising your pricing hasn't been higher yet?

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.

A

Yeah. Chris, in our stainless product group, it is a pretty broad mix. So, a good portion of it is more of the kind of stainless flat-rolled where we have followed the market trends more from a pricing standpoint. But then we've also got a lot of stainless long products in there, a lot that goes into energy. And so, in that market, we haven't seen necessarily the price increases. And even, generally, those products generally maintain their – hold their prices a little more and don't follow the general market increases the way that the flat-rolled does.

William K. Sales
Executive Vice President-Operations, Reliance Steel & Aluminum Co.

A

Yeah. Yeah. Surcharge there is less significant and particularly as a percentage of the total price. And, normally, when we're talking surcharges, we're talking the 304 stainless product which is the bigger volume product.

Chris Olin
Analyst, Rosenblatt Securities, Inc.

Q

Okay. That's fair. And just quickly shifting gears a little bit. When you do look at the M&A pipeline these days, I guess I'm wondering if you see an opportunity to expand your footprint within aerospace. I guess, do you think it makes sense to start looking into something like the titanium high-performance materials areas to get bigger on your asset base?

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

We think we have a pretty good footprint right now as we speak in the aerospace business, especially after that acquisition that we made in 2014. So, we're going to look at any and all opportunities, okay, Chris. And if something comes along with a titanium related or specialty metals related or anything else. Aerospace, we enjoy that market. We think it's very strong. We think it's got a lot of legs. I think Bill points are good for many years to come. So, any opportunity that came along on aerospace, we look at it very closely. But we're not actively going out and shaking the trees for titanium related or, what have you. Karla?

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.

A

Yeah. And we do have a titanium company we acquired back in the early 2000, it's just a small portion of our overall product mix. So, as Gregg said, we'll keep looking at all the opportunities that are out there to see what's a fit, but in aerospace, kind of distribution, there are limited opportunities out there.

William K. Sales
Executive Vice President-Operations, Reliance Steel & Aluminum Co.

A

But, Chris, we like that space.

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.

A

Yeah.

William K. Sales
Executive Vice President-Operations, Reliance Steel & Aluminum Co.

A

We would definitely look at any opportunity there.

Chris Olin
Analyst, Rosenblatt Securities, Inc.

Q

Great. Thanks for your time.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

Thank you.

Operator: Thank you. Our next question is a follow up from the line of Aldo Mazzaferro with Macquarie. Please proceed with your question.

Aldo Mazzaferro
Analyst, Macquarie Capital (USA), Inc.

Q

Hi. Thanks for the follow-up. On the market overall Gregg, are you seeing any impact on the market from the new supply out of Big River Steel at this point?

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

No. Other than one of our major suppliers, Zekelman Industries seems to be enjoying, I think [ph] he (58:36) bought the very first coil that ever came off their line. But no, we have not seen that. Are we anticipating we will be seeing that shortly? Yes, we are. And we're in touch with them, Jim and his managers are on top of that. But as of today, that we're sitting in this room, okay, we are not seeing an impact from that company.

Aldo Mazzaferro
Analyst, Macquarie Capital (USA), Inc.

Q

Great. And I guess also the same would be true for ACERO Junction, probably even earlier in their life right than Big River?

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

Yeah. Yeah. Exactly. And I think probably the people that'll see Big River first will be the Tubular's. Okay. That's where I would go if I were them so anyway.

Aldo Mazzaferro
Analyst, Macquarie Capital (USA), Inc.

Q

Okay. One...

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

Nothing right now Aldo.

Aldo Mazzaferro
Analyst, Macquarie Capital (USA), Inc.

Q

How about one final question? In the market we're in right now, with the currency of your stock being pretty high, is this the year 2017 where we might see a big move for an acquisition? Or do you think the acquisition climate is changing at all?

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

I'd have to say that really we're in the mood for a large acquisition if it fits anytime. I mean, our balance sheet at 30.3% debt to capital is solid as a rock. The availability of cash is certainly there and our appetite is there, it's just a matter of when and if the deal that we look at is appealing.

Karla R. Lewis
Chief Financial Officer & SEVP, Reliance Steel & Aluminum Co.

A

Yeah. It's making sure – I mean, it's most dependent upon they're being that good company out there of that size, we've only used our stock one time for an acquisition. We're open to doing that, but generally the sellers want cash. And I would also just like to comment, Aldo, that I certainly would consider our stock price high, I would think that we're finally showing a more reasonable value with much more room to grow.

Aldo Mazzaferro
Analyst, Macquarie Capital (USA), Inc.

Q

Great. I appreciate that very much, Karla. Thanks for all the color.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

A

Thanks, Aldo.

Operator: Thank you. Mr. Mollins, there are no further questions. At this time, I'd like to turn the floor back to you for final remarks.

Gregg J. Mollins
President, Chief Executive Officer & Director, Reliance Steel & Aluminum Co.

Okay. Thank you. On behalf of our team here at Reliance, I'd like to thank all of you for participating in today's call. I also like to thank our loyal employees, customers, suppliers and stockholders for their continued support and commitment which has helped shape Reliance into the strong company that it is today. We look forward to a productive 2017. And have a great day. Thanks for joining us.

Operator: Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.