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RS - Q2 2015 Reliance Steel and Aluminum Co Earnings Call

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OVERVIEW:

Co. reported 2Q15 consolidated net sales of $2.42b and net income attributable to Co. of $90.2m or $1.20 per diluted share. Expects 3Q15 diluted EPS to be $0.95-1.05.

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PRESENTATION

Operator

Greetings, and welcome to the Reliance Steel & Aluminum Company second quarter 2015 conference call. At this time all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. (Operator Instructions). As a reminder, this conference is being recorded. I would now turn the conference over to your host, Ms. Brenda Miyamoto, Investor Relations for Reliance. Thank you, Ms. Miyamoto, you may now begin.

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

Thank you Operator. Good morning and thanks to all of you for joining our conference call to discuss our second quarter 2015 financial results. I'm joined by Gregg Mollins, our President and CEO, Karla Lewis, our Senior Executive Vice President and CFO, and our Executive Vice President of Operations, Jim Hoffman and Bill Sales. David Hannah, our Executive Chairman, will also be available during the question-and-answer portion of this call. A recording of this call will be posted on the Investor section of our website at Investor. RSAC.com.

The press release and the information on this call 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 achievements of the Company to be materially different than 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 31st, 2014, under the caption Risk Factors, and other reports filed with the Securities and Exchange Commission. The press release and the information on this call speak only as of today's date, and the Company disclaims any duty to update the information provided therein and herein. I will now turn the call over Gregg Mollins, President and CEO of Reliance.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Good morning everyone, and thank you for joining us today. I am extremely pleased with our operational performance in the second quarter of 2015, which is a testament to the quality of our management team in the field, as well as to our business model. Despite ongoing industry headwinds that further pressured metal pricing in the quarter, we were able to increase our FIFO gross profit margin to 25.7%, up from our strong 2015 first quarter FIFO gross profit margin of 25.4%. We believe that our continued focus on small, quick turnaround orders and inventory turns, allows us to maintain consistent gross profit margins, and that our significant investments in equipment in recent years, to provide higher levels of value-added processing to our customers, has further enhanced our ability to maintain and improve our gross profit margins, even during difficult business environments.

We believe our position in the market has also contributed to our ability to increase our market share. With our tons sold in the first half of 2015 decreasing by 0.6% compared to the first half of 2014. Compared to the MSCI industry average of a decrease of 5%. Although our second quarter tons shipped were lower than we had anticipated, we believe that underlying customer demand remains relatively strong. In particular, the aerospace and automotive end markets remain strong, and we see ongoing opportunities for continued growth in these markets. We also continue to be encouraged by slowly improving momentum in our activity levels in the non-residential construction market, our largest end market. Although lower oil prices have significantly reduced demand for our business serving the energy market, our ongoing cost reduction initiatives and disciplined sales strategy have helped mitigate the impact on our overall profitability.

Pricing for all commodity types continued to weaken as the second quarter progressed, primarily due to historically high level of imports, supported in part by the strength of the US dollar. In fact, pricing was even softer than we had projected heading into the second quarter. As a result, same-store average selling price per ton sold declined 5.3% for the second quarter of 2015 compared to the prior quarter, and declined 8.6% from the second quarter of 2014. On a positive note, we have started to see pricing begin to firm for certain products in recent weeks, and we are cautiously optimistic that overall metal prices will trend modestly higher in the second half of 2015. In light of the difficult pricing environment, we remain highly focused on managing all aspects of the business that are within our control, which continues to lessen much of the impact from the challenging market conditions.

In 2015 we have had a significant push on reducing inventory, and I am proud to report that we've decreased our FIFO inventory by $163 million during the second quarter. This is a significant accomplishment for our Company, and using our June 30th, 2015 FIFO inventory tons on hand and our first half 2015 shipment levels, our inventory turn rate would be 4.6 times. This is the first time in many years that we have been this close to achieving our internal company-wide goal, which is currently 4.75 turns. I want to personally thank all of our employees that helped us achieve these results. I attribute our progress to refocusing our team on several critical factors that have led to Reliance's Best-in-Class inventory management, and these include, compensation plans for our executives and managers in the field that reward working capital management. Our track record and strong preference to purchase domestically produced materials over imported materials that require much longer lead times. Our focus on customers requiring smaller quantities of material and just in time inventory management practices. And finally, the significant inter-company support and sharing of Best Practices among the Reliance family of companies, that includes nearly 300 service center locations.

I firmly believe that our improved inventory management contributed to an increase in our FIFO gross profit margin to 25.7%. As a result of our solid gross profit margin and effective expense control, second quarter net income attributable to Reliance was $90.2 million, and earnings per diluted share were $1.20, above our guidance range for the quarter. Our significant inventory reductions contributed heavily to our strong cash flow from operations in the second quarter of $292.5 million. Through the first half of 2015, we have generated a total of $464 million in cash flow from operating activities. We are pleased with this result, which highlights our ability to consistently generate cash flow through various industry cycles.

In the second half of last year we completed the acquisitions of All Metal Services, Northern Illinois Steel Supply, and Fox Metals and Alloys. That contributed to our second quarter 2015 consolidated net sales of $2.42 billion. In total, we sold 1.51 million tons of metal during the second quarter of 2015. While we have not completed any acquisitions so far in 2015, we continue to see and evaluate opportunities, and as always, M&A will remain an integral part of our overall growth strategy. We expect to continue to be a consolidator in our highly fragmented industry, by making strategic acquisitions of well managed metal service centers and processors, with end market exposures that support our diversification strategy. Our liquidity position and confidence in our operational execution provide a strong foundation for us to continue to grow our business through

M&A and organic initiatives, while at the same time deleveraging our balance sheet, and returning value to our shareholders through dividends and opportunistic share repurchases.

During the second quarter we repaid $156 million of debt, in the first six months of 2015 we repurchased $200 million of our common stock, and have repurchased an additional $61.5 million so far in July. On July 21st, 2015, our Board of Directors declared a regular quarterly cash dividend of $0.40 per share of common stock. As we have noted in the past, Reliance has a broad range of products, significant customer diversification, and a wide geographic footprint. Our high volume of small, quick turnaround orders and value-added processing, coupled with our disciplined sales strategy, has helped the Company maintain and increase our gross profit margins, even in today's difficult pricing environment.

We have a very experienced team at Reliance, and achieved industry-leading operating results, and we remain confident in our ability to continue our track record of success going forward. I would now hand the call over to Jim to comment further on our operations and market conditions. Jim.

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

Thanks Gregg. Good morning everyone. Our remarks today will focus primarily on price and demand for our carbon steel and alloy products, as well as on our outlook on certain key end markets we sell those products into. Bill will then address our aluminum and stainless steel markets. From an end market perspective, automotive served mainly through our toll processing operations in the US and Mexico remains very strong, and we believe this will continue. Our toll processing operations in the US are expanding primarily in support of aluminum products now going into the automotive market. We are also adding a facility in Mexico to support the increased automotive activity in that area. Heavy industry, such as railcar, truck trailer, ship building, barge and tank manufacturing, and wind and transmission towers, are all doing reasonably well. Agriculture and construction equipment have come off their peak, but we still are seeing good demand and remain well-positioned to continue to service these important end markets.

Non-residential construction is our largest end market, and although we have seen demand continue to improve, it remains well below peak levels. We are optimistic that this important market will continue to improve gradually throughout 2015 and 2016. We have made significant investments in our businesses serving this space, that will allow us to provide a higher level of value-added processing to these customers as their volumes increase. Energy, that being oil and natural gas, has slowed down due to the severe drop in oil prices and the related reduction in drilling activities. Our second quarter volume sold into our energy businesses declined approximately 35% from our volume in the first quarter of 2015, which was down 30% from the prior year.

Because we began the process of reducing our expenses and inventory levels related to that market early in the fourth quarter of 2014, and have continued to do so as demand continues to decline, our energy businesses as a whole remain profitable in the second quarter of 2015. However, pretax income for these businesses was down over 85% compared to the second quarter of 2014. Carbon steel prices continue to be under a great deal of pressure in the second quarter, mainly due to continued record high import levels in the marketplace, as well as a rapid decline in raw material prices, a strong US dollar, a soft global economy, and high inventory levels throughout the supply chain. However, in this environment we actually increased our FIFO gross profit margin on sales of our carbon products in 2015 second quarter, as compared to both the 2015 first quarter and the 2014 second quarter.

Our success is due to many factors, including our product mix, quarter size, our excellent customer relationship, and our strong supplier partnership, along with increased value-added processing. Flat rolled pricing has been under pressure since late in the third quarter of last year. There have been some recent price increase announcements, with a portion of these increases holding on so far. Carbon flat rolled products represent only 15% of our total sales, with hot rolled at 7%. We believe the recent trade case filings on coated products has been supportive of domestic prices, and anticipate that any additional filings would also be positive for pricing.

Plate represents the largest portion of our product mix, followed by carbon steel structurals, bars, and tubing. Therefore, the results are more impacted by pricing in these products. Pricing for these products continues to be under pressure. However, we believe current prices are near the bottom, and we anticipate the potential for a moderate increase for certain carbon products by the end of 2015. Pricing for alloy products, a majority of which are sold into the energy end markets, has held fairly steady considering the significant reduction in demand this quarter. We expect prices for these products to remain fairly steady with current levels, due in large part to product going into the automotive market. I will now hand the call over to Bill to comment further on non-ferrous markets. Bill.

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

Thanks Jim. Good morning everyone. The aerospace market continues to be a bright spot for us. Demand has remained strong, and we expect it to improve throughout the balance of the year, as build rates in the commercial airline market continue to grow. We've increased our presence in this area with the acquisition of All Metal Services, headquartered in the UK, in August of 2014, as well as the opening of two new AMI metals facilities in France and Turkey in the first quarter of 2015. Sales to the aerospace market have increased as a percentage of our total sales, now representing approximately 8% to 10% of our total sales in the second quarter of 2015. In addition to these growth activities, our same-store tons sold also increased significantly, reflecting the improved underlying demand. This is a good market for Reliance, and we expect to continue to grow in this area as we support our global customers.

The majority of the products that we sell to the aerospace market are heat treated aluminum products, especially plate, as well as specialty stainless and titanium products. Given the strong underlying demand, the price for aerospace aluminum plate has improved over last year. Lead times are out 24 to 28 weeks, up from the 13 to 17 weeks we saw in January. Both price increase announcements for this year have held, and this product is in tight supply. We believe the aluminum plate overhang that has existed for the past few years has generally worked through the system. Our sales of common alloy are up slightly from a volume standpoint, with most of our product being sold to sheet metal fabricators that support a variety of end markets, demand on general engineering aluminum plate remains strong, with domestic lead times around 25 weeks. The price increase for March has held with the domestic mills, but import pricing continues to be aggressive.

Demand for semiconductor plate remains strong, and the outlook is good for the balance of the year. Pricing on common alloy sheet follows ingot, and has deteriorated from prior year levels, due to increased imports, as well as a significant reduction in the Midwest premium. Midwest spot ingot has been trading in the $0.80 to $0.85 per pound range, down from the $1.06 per pound we saw in January. The conversion premium was at a historically high level for longer than we had anticipated, and has decreased about $0.16 a pound since the beginning of the year. Outside of the energy market, demand for stainless steel products continues to be good. We sell a significant amount of stainless steel flat products into the kitchen equipment, appliance, and construction end markets. Lead times are about four to five weeks. Pricing for stainless steel products is heavily impacted by nickel prices, which began the year at $7.37 per pound, and is currently down $1.51 at $5.86 per pound for July.

As an example, surcharges for 304 have fallen from $0.76 per pound in January to $0.57 per pound in July. In addition, base prices have dropped a few discount points due to a heavy influx of import products. We expect prices for stainless steel products to remain steady to up slightly for the remainder of 2015. I now turn the call over to Karla, to review our second quarter financial results in more detail.

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

Thanks Bill. Good morning everyone. Given the market conditions discussed earlier, our 2015 second quarter tons sold and average selling prices were down compared to both the 2014 second quarter, as well as the 2015 first quarter. Sales from the companies we acquired in 2014 helped soften the decline in our tons sold, as well as our average selling price, since most of these companies sell specialty products or provide higher levels of value-added processing, resulting in selling prices above our company-wide average. Our same-store average selling price has declined sequentially in each month beginning in September 2014, with our June 2015 average selling price down $200 per ton, or 11.5% from our September 2014 average selling price.

Based on our 2015 second quarter same-store tons sold, this equates to a loss of nearly $300 million in quarterly sales, or $1.2 billion per year due to the impact of metals pricing. And as we have explained before, the majority of lost sales from pricing also result in lost earnings. Because metals pricing, especially for carbon steel products, declined more than we had anticipated in the 2015 second quarter as compared to the 2015 first quarter, we increased our annual estimate of our LIFO adjustment to income of $80 million, compared to our prior estimate of $30 million. This resulted in a LIFO credit or income of $40 million for the 2015 first half, with $32.5 million, or $0.27 earnings per diluted share, included in our cost of sales in the 2015 second quarter, compared to $7.5 million of LIFO income, or $0.06 per share in the 2015 first quarter. In the 2014 second quarter, when metal prices were generally rising, we recorded a LIFO charge or expense of $5 million, or $0.04 per share. This adjustment reflects LIFO accounting working in the manner intended, reducing FIFO cost of sales in a declining price environment.

The majority of our LIFO income is attributable to our carbon products, as carbon suffered the most pricing pressure in the quarter, and represents 80% of our inventory tons, and 50% of our inventory dollars. Our updated annual LIFO income estimate of $80 million, assumes that pricing for certain carbon and stainless steel products will increase modestly from current levels by the end of the year. Our 2015 second quarter gross profit margin of 27.1% was up from 25.7% in both the 2014 second quarter and 2015 first quarter. Our increased LIFO income contributed to our increased gross profit margin. On a FIFO basis, our gross profit margin during the quarter exceeded our expectations, especially considering the declining price environment. Given the competitive market and lower prices, we anticipated that our gross profit margins would decline, however, as highlighted previously, our teams in the field did a great job of maintaining and increasing our gross profit margin.

Our 2015 second quarter SG&A expenses decreased modestly from both the 2014 second quarter and the 2015 first quarter, primarily due to effective cost control throughout the Company, including decreased headcount in our businesses servicing the energy end market. As a percent of sales, our SG&A expenses were 18.2%, compared to 17.0% in the 2014 second quarter, and 17.1% in the 2015 first quarter. The increase as a percent of sales was impacted mainly by lower selling prices in the 2015 second quarter. Using our average selling price in the 2015 first quarter applied to our 2015 second quarter volume, results in SG&A expense as a percent of sales of 17.3%. As individual markets change, we will continue to remain disciplined in our efforts to adjust our variable expenses, such as personnel costs, which represent about 60% to 65% of our SG&A expenses. Our quick reaction to the significant decline in sales volume to the energy market allowed us to remain profitable in our energy businesses in the second quarter of 2015, which we believe is quite remarkable. Although our pretax income of $135.9 million declined from the 2014 second quarter and the 2015 first quarter, we are very pleased with our pretax income margin of 5.6% for the quarter, given the difficult pricing environment. Again, this was possible because of our strong gross profit margins.

Our effective income tax rate for the quarter was 32.6%, compared to 36.6% in the 2014 second quarter, and 31.7% in the 2015 first quarter. Our tax rate in the 2014 second quarter included the effect of a gain on the sale of certain non-core assets. In addition, our 2015 rate is benefiting from lower tax rates in certain states and foreign jurisdictions. And we currently expect that our full year 2015 effective income tax rate will be in the range of 32% to 33%. In 2015 second quarter, we closed a facility that was not performing in line with our expectations, resulting in a charge of $0.8 million included in our SG&A expenses, which is presented in our table of non-GAAP net income and earnings per share amounts in our press release issued earlier today.

Net income for the 2015 second quarter was $90.2 million, or $1.20 earnings per diluted share, well above our guidance range. Going to our inventory reduction efforts, we generated cash from operations of $292.5 million during the 2015 second quarter. We typically use cash in the first half of the year, as we build working capital from seasonally lower fourth quarter levels. However, given declining metal prices, along with strong gross profit margins, and our successful efforts to reduce our inventory levels, we were able to generate $463.9 million of cash from operations in the 2015 first half. Given our current expectations for both pricing and demand in the 2015 second half, along with our continued efforts to further improve our inventory turns, we expect to continue to generate cash from operations, but not at the same rate as in the 2015 first half.

On the working capital front, we continue to manage our receivables well, with our Accounts Receivable Day Sales Outstanding rate at June 30th, 2015 of 42.1 days, in line with our historical range. Our inventory turn rate at June 30th was 3.9 times based on dollars, and 4.4 times based on tons, both fairly consistent with the prior quarter. However, given the significant inventory reductions in the 2015 second quarter, we expect these rates to improve as we move through the year. As Gregg mentioned earlier, using our June 30th inventory on hand, and our 2015 first half shipment levels, our turn rate is 4.6 times on tons.

We used cash from operations to pay down $156 million of debt during the quarter. At June 30th of 2015, our total debt outstanding was $2.2 billion, resulting in an improved net debt to total capital ratio of 33.9%. As of June 30th, 2015, we had $585 million outstanding on our $1.5 billion revolving credit facility. We spent $45.8 million on capital expenditures during the 2015 second quarter, and our full year 2015 CapEx budget remains $200 million, the majority of which relates to growth activities. We also paid quarterly dividends of $29.7 million during the quarter, and further enhanced our shareholder returns with share repurchases. In the 2015 first half, we repurchased $200 million, or 3.4 million shares of our common stock, at an average cost of $58.17 per share. As a result of these repurchases, we realized an EPS benefit of $0.05 per share during the 2015 second quarter. And given that our stock price has continued to be undervalued, along with our strong cash generation, we have been in the market recently, repurchasing approximately $61.5 million of our shares so far in July. We expect to use available cash to continue to opportunistically repurchase shares of our common stock, as well as to pay our quarterly dividends, reduce our debt, and support our various growth activities.

Now turning to our outlook, overall we expect the US economy to continue its modest improvement throughout the remainder of 2015. With the exception of our businesses directly servicing the energy markets, we expect underlying demand to generally strengthen from second quarter levels, subject to normal seasonal patterns. That said, we anticipate a decrease in tons sold of 1% to 2% in the third quarter of 2015 over the second quarter of 2015, compared to the more typical seasonal trend of down 3% to 5%. Although we expect metals pricing to remain under pressure for most products we sell, we do expect a slight improvement in overall pricing from current levels, with our overall average selling price expected to be flat to up 1% from second quarter levels. And given this environment, we would expect to be able to generally maintain our current FIFO gross profit margin with the potential for downward pressure. Based on our current annual LIFO income estimate, we expect LIFO income of $20 million in the 2015 third quarter, down from our second quarter amount, which would reduce our reported gross profit margins as well as earnings.

As a result, we currently expect earnings per diluted share to be in the range of $0.95 to $1.05 for the third quarter ending September 30th, 2015. We are confident in our ability to continue to effectively manage the controllable aspects of our business, to mitigate the volatile factors that impact our industry. Our effective working Capital Management and consistent gross profit margins, provide strong cash flows that allow us to continue to fund growth, while at the same time providing steady returns to our shareholders. That concludes our prepared remarks. Thank you for your attention. And at this time, we would like to open the call up to questions. Operator.

QUESTIONS AND ANSWERS

Operator

Thank you. Well now be conducting a question-and-answer session. (Operator Instructions). Our first question is from Tony Rizzuto of Cowen and Company. Please go ahead.

Tony Rizzuto - *Cowen and Company - Analyst*

Thanks very much. Hi, everyone.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Morning, Tony.

Tony Rizzuto - *Cowen and Company - Analyst*

First of all, congrats to you, Gregg, on taking over the helm, and to you David, for your exemplary efforts over the last two decades in guiding the Company through a great deal of success. So congratulations to both of you guys.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Thanks.

Tony Rizzuto - *Cowen and Company - Analyst*

You are quite welcome. My first question, Gregg, on your last conference call you were pretty adamant about the carbon flat mills needing to grab the bull by the horns and raise prices, and shortly thereafter prices rose. So I'm very curious as to how you're thinking today, and can the current environment accommodate any further price hikes in carbon flats?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

I feel, Tony, obviously with the imports where they are, there's some difficulty there, however, they seem to be diminishing, and I think the recent price announcement from US Steel has partially held. And I can see carbon steel products pricing going up, especially with the trade case that's been filed, and I think will be supported, and I would be surprised if there weren't more trade cases on other flat rolled products to follow. So to answer your question, I think the mills have reacted well, and raised those prices, we're proud of them for doing that, and we feel that they have a better chance of success than not.

Tony Rizzuto - *Cowen and Company - Analyst*

Gregg, you indicated that X hike, that $40, or at least a portion of it is sticking out there. How come we've seen the consultant group seem to be a little bit slow in maybe picking that up? We've seen some improvement there, some of it is sticking? What portion?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

It's in the neighborhood of about $20 a ton.

Tony Rizzuto - *Cowen and Company - Analyst*

So --

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

I think the consultants may look more at the contractual business more so than the spot, and I think those prices are holding better in the spot business than probably they are in the contractual.

Tony Rizzuto - *Cowen and Company - Analyst*

Okay. All right. Thank you for that. And you guys indicated that the second quarter demand levels were somewhat below expectations, and I was wondering, I may have missed some of this, and I apologize, I just bounced off another call and maybe missed some of your commentary there. But could you provide some color on the specific areas of shortfall, and what gives you guys confidence that the US economy continues on the path of recovery? Because we've been having some conversations, and it seems like there's a growing level of caution out there being voiced by people we talk to?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Well, we were a little disappointed in our second quarter volumes, primarily because our second quarter generally is better than our first quarter. And in this particular case, that didn't transpire. On the other hand, I will say that a portion of that decline in our volumes was related to, we reduced our inventory $163 million in the quarter, we were not chasing business that was unprofitable, okay? Because we didn't have the need to blow out inventory. We received less inventory from offshore purchases. So we just took a very disciplined approach to our pricing, and there was some tonnage reduction due to that. But that was a strategy of ours because we are not chasing business that we believed, and well we knew, was just not profitable at all. So that had a little bit to do with it. But in general, our second quarter in volume-wise is better than our first, and in this particular case, with the exception of what I just described, it did seem a little softer than the first quarter, which historically speaking, is a little unusual.

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

And we, Tony, our tons were pretty much in line with the MSCI industry averages of what happened in the second quarter. I think the industry was down about 2%, and we were down 2.1%, which could support your question about, is underlying demand slowing, but based on what we're hearing from the field, with the exception of energy, we're still confident that there is continued underlying demand growth, some markets stronger than others, and so we're still confident in the outlook.

Tony Rizzuto - *Cowen and Company - Analyst*

Okay. And my final question is on the aluminum plate market, and again I apologize, I may have missed Bill's comments earlier, but just in general engineering, is the demand still improving, more lead times now, and what about import pressures we're hearing of greater import pressures out of South Africa and Europe, and we are increasingly concerned about what the Chinese are doing. I was just wondering if you could bring us up-to-date with what's going on in those markets?

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

Yes, Tony. Lead times are running about 24 to 28 weeks. The aerospace part of that business is extremely strong. The supply side is tight. General engineering, we are seeing aggressive import pricing. There is more product coming in from China. And the outlook really into the, we'll see, I think, more of that in the second half and then getting into 2016, we think the general engineering market is going to be, margins will be under pressure there. But that's not impacting aerospace at all. Our outlook for aerospace through 2016 is very positive.

Tony Rizzuto - *Cowen and Company - Analyst*

But one of the concerns that you and I have talked about in the past is that material tends to kind of find its way into a little bit of overlap in these markets. Are you concerned at all that as quality continues to rise, is there any learn come of that excess supply in general engineering could soften up the heat treat market for Arrow? Is that a concern of yours as you go into 2016?

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

Not in the outlook that we're looking at. I think when you look long-term, there's some potential for that down the road, but that's pretty far down the road.

Tony Rizzuto - *Cowen and Company - Analyst*

Okay. Great. All right. Great color everybody. Thank you so much.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Thanks Tony.

Operator

Thank you, the next question is with Timna Tanners with Bank of America Merrill Lynch. Please go ahead.

Timna Tanners - *Bank of America Merrill Lynch - Analyst*

Hi, good morning, everyone.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Good morning, Timna.

Timna Tanners - *Bank of America Merrill Lynch - Analyst*

That was a really thorough overview and outlook, so I wanted to thank you. It doesn't leave us as much to ask about as maybe in the past, but I did want to hone in on what Karla was saying about the ability to maintain overhead and how much of it is labor, because it is pretty remarkable that despite the lower earnings, you've also been able to contain the overhead. So I just wanted to get a sense from you, how much it needs to improve, how that can be sustained if volumes improve going forward, or how to think about that number in the next couple of quarters? Thanks.

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

Yes, hi Timna. So from an expense standpoint, certainly we've got our fixed costs with all of our service centers that we have out there, and we've got a lot more capacity from a fixed cost standpoint, to put a lot more tons through our businesses, especially in a lot of our non-res facilities, where we expect demand to continue to improve. This is the variable cost component if we're handling more material, we might have to add a few more bodies, typically in the warehouse, or drivers to move the material, but that's something, it's not really a one-for-one increment. We can absorb more volume in our current structure, and the people part is about 60% to 65% of our SG&A expenses, so that's where we typically can attack cost or increase. For instance, in the energy businesses, we've had to reduce headcounts and other costs, but primarily headcount quite a bit. At the same time, some of our businesses, like the aerospace businesses as Bill talked about, or our toll processing for automotive were growing, so we were adding people at some of those facilities, but as you can see in the results, we were able to reduce costs overall. So we'll continue to do that. We look at each of our businesses individually to see what's going on there. We've said before we think kind of in a normal demand and pricing environment, which we don't believe we're in currently. We think our SG&A expense should kind of be in the 14.5% to 15% of sales range, we're up to 18% now, but we would expect it to trend down a little bit as we move forward, but certainly we won't get down to that normal level in 2015.

Timna Tanners - *Bank of America Merrill Lynch - Analyst*

Okay. It's been really nicely contained. So thanks for that color. I just wanted to take a step back and ask some more about non-res construction demand, and I feel like for the last, you said this isn't normal demand, and I think we've been saying it's not normal non-res demand, and expectations seem to be for better growth this year when we were talking about it last year. I just wanted to get a sense from you guys, what it will take to get a more positive outlook, or what kind of trends we can look for, is it really just the energy market that's kept a dampener on the overall non-res market or are there other factors? Thanks.

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

Timna, this is Jim. We have some lead indicators. Our companies out in the field, they've got really good relationships with their end use customers, so some of these very large contractors and fabricators, they give us really good color on what they see as far as what backlogs they already have, what jobs are on the horizon, so we've got a lot of insight there. Also, our strong supplier relationships. In the non-res business, the producing mills pick up first. Because the these big jobs that are quoted, they go mill direct. Once the big mill direct jobs start working through, that's when they call us for the smaller pieces of the business. So the indicators are there. Another thing, when you go back to when it wasn't very good at all back in 2009, 2010, there may be a job that's being quoted out there, and you'd have 30 different contractors bidding on the job from all over the United States, even though the job itself was in Stockton, California. Now it's back to kind of the usual suspects, the three or four local guys that basically do construction in that area. But right now we're positive on the outlook. It's up. It continues to be good. It's still way off its peak. We've got plenty of room to grow along with it. And it just feels better, looks better, and all of our lead indicators say that in fact it is better.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

We are getting a lot of positive, as you're hearing from our steel producers and our quoting activity has improved, and it has improved fairly steadily over the past few years. So that's always a good indicator. Our volumes are pretty good. The region with the most activity is the northeastern part of the United States, the West Coast is strong, Texas even with regard to the softness in the energy market, they're still building there. The LNG plants are strong. Hospitals, schools, businesses in that regard are doing better. So we think that we're going to see growth in the non-res business going forward.

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

Timna, one more point on the second part of part of your question, what would it take. There is pent-up demand. If our government would pass a comprehensive transportation bill, no matter where you are in the country, you can see bridges that are on the verge of collapsing, unfortunately, and when that does happen, things will get better because there's a lot of steel that goes into the infrastructure. Whether it's bridges, whether it's water treatment, on and on and on. So that would be something that would, I think would be good for everybody.

Timna Tanners - *Bank of America Merrill Lynch - Analyst*

Okay. Great. And just one last one, I wanted to get your sense on the stainless imports, stainless sheet imports, and carbon plate imports, we're starting to hear maybe a possibly also of trade cases being pursued there. Do you think that market is being unfairly treated by imports, and that there could be a trade case in either of those commodities? Thanks.

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

Hey, Timna, it's Bill. I'll address the stainless part of that. We are hearing a lot of discussion from our suppliers about the potential for a trade case. Obviously the commodity part of the stainless flat business has been very, very competitive, and you can see the impact of that from some of the financial results from suppliers, and then have read where, one of the major domestic guys has said that a trade case is likely. So we'll kind of step back and watch that. But there absolutely is a lot of discussion about that possibility, and it seems to be gaining momentum.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

And from the carbon plate side of the business, Timna, we'd be surprised if there was not a trade case filed in that. There's been so much of that material coming into the United States from foreign suppliers at a ridiculous rate. So the price spreads there in that particular commodity are still fairly significant.

Timna Tanners - *Bank of America Merrill Lynch - Analyst*

On carbon plate, you're talking about?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

On carbon plate. Bill commented on the stainless and I'm commenting on the carbon plate. We'd be surprised if there wasn't a trade case filed for that. There certainly should be. There's unfair dumping that's taking place in huge amounts. And we hope that there's a trade case filed.

Timna Tanners - *Bank of America Merrill Lynch - Analyst*

Okay. Great. Thanks for all the detail.

Operator

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

Operator

Please go ahead.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Good morning. Karla, I just wanted to qualify your comments on the FIFO gross margins in the third quarter. Did you say that you expected to maintain with some downward pressure? I wasn't quite sure if that's what I heard, but that's what I thought you said?

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

Yes, that is what I said, Phil. I mean, as we commented on during our prepared remarks, the 25.7% gross profit margin achieved during the second quarter, we were very pleased with again. You may remember when we talked to you in April, that we were telling you we were pleasantly surprised that we were able to maintain FIFO gross profit at 25.4% in the first quarter. Given the competitive markets out there, the amount of import in there. And we're really pleased with the performance of our people, and the fact that they increased those margins in Q2, we think is wonderful. We do think there are reasons why you're seeing our margins hold, because of the things Gregg talked about in our business model, the quick turn orders we go after, the high value add, so we do think we'll continue to have strong gross profit margins. However, there's still a lot of metal out there, so there could be some pressure because the 25.7% is a really strong level given the environment. So we're typically a little conservative. So we would anticipate the potential for some downward pressure. Not significant, but a little downward pressure in the third quarter.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Okay. And I know you're really focused on the quick turn business, as you always have been, but maybe Metals USA is focused more on larger orders, given the OEM bias that they have. Is there anything that you could give us a view into there that could be a little bit different, meaning the purchasing behavior of the OEMs, are they more likely to be looking offshore for steel, are they more cautious in buying large order patterns, have they backed away? Just trying to maybe see what the difference is relative to the legacy business?

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

The behavior of the OEMs has not changed dramatically other than the fact that they've seen prices going down, so they're being more conservative on their buys. And Metals USA has gained more momentum on the smaller order size business, because of the environment that they're now in Reliance speak. But as far as the OEMs, we're just seeing the OEMs reduce their buying patterns. It's not like they're cutting back their tonnage, they're just buying it more frequently, more often, okay. And just being conscious of the fact that metal prices are under pressure due to offshore.

We don't see a lot of buying from OEMs going outside of the country. It's still retaining pretty much with the domestic producers. So we're not seeing any change in behavior there.

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

And also, Phil, by the time, when we acquired Metals USA in 2013, they had been diversifying their business a bit, so they probably weren't as heavily kind of that OEM type business you're talking about, as they had been a few years prior to that. And even in the Reliance legacy business, certainly we're much more diversified and probably more next day delivery type orders than Metals USA had been, but we've always had some portion of OEM type business in the legacy Reliance business also.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Okay. And then I'll just ask this last one if I could and jump right off. Gregg, do you feel like you're losing any share as an industry, or have lost share as an industry to direct import buys, and how do you expect that to unfold in the next couple of years? Thanks.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

I don't think we've lost any meaningful business with any of our customers going offshore. As I said earlier, I think we've lost a little bit of tonnage business volume, okay. But from businesses that very honestly, we just didn't want to take the business. There's some competitors out there that have too much inventory, and they're doing whatever it takes to get rid of that inventory. We're not in that position. So we're choosing to pass on some of that volume. But as far as market share concern, we think we're building our market share. We've spent a lot of money in CapEx spending. We've got great equipment out there that has tolerances that very few people have. Our CapEx budget for like the fourth year that row is at the $200 million mark. So we're investing all the time in our businesses, so that they can have the highest quality. We focus on our lead times to be reduced. So we think that we're going to continue to grow market share as time goes on, and we don't believe that we're losing any market share, other than the fact that some business that we choose not to take because it's not profitable, we're going to pass on.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Thanks Gregg.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Thank you.

Operator

Thank you. The next question is from Luke Folta of Jefferies. Please go ahead.

Luke Folta - *Jefferies - Analyst*

Hi, good morning.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Good morning, Luke.

Luke Folta - *Jefferies - Analyst*

I wanted to touch on something that I brought up last quarter, and I know it can be complicated to sort of summarize, but just on your average selling prices when you look at your realized prices, really in each category relative to the spot indexes, they moved up quite a bit. Your spreads over sort of spot pricing moved up quite a bit in the first quarter. And I came away from last quarter's conference call thinking that some of that was temporary, and that you could hold up your selling prices a little better on the way down than maybe the market as a whole. But as we look at that number into the second quarter, in most cases it's actually gone up further. So I guess well done on that side. I guess when you think about the drivers of this, you may have answered the question earlier, just with your comments on discipline, and trying to maintain selling prices and margins, but what do you think the big drivers of that are?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

I think it's just that. We're reducing inventory throughout the entire corporation. We're focused on that. On the other hand, we're looking at every invoice line, every order, every customer, because we recognize the fact that when you have prices that are as low as they are today in most all of our products, your saving grace is gross profit margin management and expense control. So we're just focused heavily, okay. I mean, Jim and Bill are sitting here next to me, and there's not a time I walk by their office that I don't hear them on the telephone talking about gross profit margin management and inventory turn.

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

Luke, the other thing is, this is Jim. Out in the field, our guys, they don't focus on moving tons. It's not part of what we do. They focus on their pretax profit earnings and gross profit, and taking care of customers. They really don't discuss how many tons are we moving out here. So I think everything that Gregg says is spot on. And it's just part of our culture.

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

And that's all true, and I think also when you compare to indexes, and I think we talked about this a little bit before, is the mix also, because we've got a lot of specialty type products, within some of those broad categories when we report on carbon, stainless, aluminum, alloy, but within that there's a mix, and we've really over the years focused on trying to become as much specialty type, higher value products as we can. So I think that also impacts on that comparison to the indexes.

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

Yes. Good example of that is on the aluminum side, with the acquisition of All Metal Services. Their average selling prices are much higher than what our average had been, because it's aerospace business or aerospace products, so you'll see an impact from that.

Luke Folta - *Jefferies - Analyst*

Particularly impressive in the sense that normally when you employ the strategy of maintaining discipline on pricing and margins, that typically comes with, you normally hear those companies talk about share loss as a result of that. And really in your case, you've been gaining share at the same time as doing that. So it's pretty interesting. Second question--Go ahead, I'm sorry.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Just a quick comment. The business out there is not bad, okay. We'd like to see energy doing better, but other than that, when you get away from that into the other markets, okay, it is pretty strong. And if you can keep your lead times low, your on time delivery intact, and something that our customers can depend upon, and you have relationships with your customers, with your outside and inside salespeople, okay. You can get an extra penny here and there, which is exactly what happened with the 25.7%. So our people in the field are pretty darn good at blocking and tackling, and doing the basic fundamentals well.

Luke Folta - *Jefferies - Analyst*

Okay. Just on inventories, from your perspective, if you look at the MSCI members and the trends that we see there, it looks like in aggregate, inventories are starting to move towards the long-term average levels, with regards to months on hand, but I mean, do you see pockets of inventory out there, whether it's at the port as a result of imports, or at the end user level, that would make it, I guess do you think the MSCI numbers are really indicative of the market as a whole, or is there excess inventory out there that's not reported?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Karla?

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

I think one of the things, at least when we look at the MSCI data that's out there, it's very heavily weighted towards flat rolled products, and with flat rolled, certainly the majority of that goes into automotive, which has been a good strong market, so we think that has been positive for the inventory numbers that are being reported overall. When you look at some of the individual products, I think there might be a few ports that Gregg or Jim could comment on, where there might be some inventory sitting around.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

The typical ports that we all hear about, i.e. Long Beach and Houston in particular, okay, do they have their fair share of material on the docks there, yes they do. Will it be there short-term, long-term? Short-term, certainly it's going to be there. And that's problematic. But you hear that imports are starting to decline, that licenses are going down, but when I look at that information very honestly, and I still see it at the 3 million ton mark per month, when it used to be, Jim, what is it now? It's somewhere around 35% of tons being consumed in the United States is coming offshore?

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

Historically it's been in the 20s, and it's still up in the upper 30s, in May it was actually 39%. Which is unheard of.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Yes. So we're hopeful that that's going to decline. We think it's going to decline. But we're running our business like it's not going to decline.

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

Yes, and the inventory at the docks and things, that's not reported in the MSCI data, because it's not owned by the service centers at that point. And overall we think service center inventory levels are reasonable, but generally industry-wide they're in good shape. Just like a lot of other companies, Reliance focused on bringing our inventories down in the quarter. So we think overall they're in good shape. Energy, there might be a few customers or service centers that are a little heavy with some of the energy products, but outside of that, we think it's in pretty good shape.

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

Overall, I believe MSCI has reported 2.7 months on hand, which is very manageable. You take lead times with that kind of inventory load, that's okay. I'm good with that.

Luke Folta - *Jefferies - Analyst*

Okay. Great. And just one last one if I could on CapEx. You often don't spend what the full year forecast at the beginning of the year is, so just give us an update on what you think you might spend in terms of for 2015, and then just trying to think of the go forward. If we stripped all of the growth out of that number and just looked at a maintenance sort of CapEx spend, what would that look like?

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

This is Jim again. Our CapEx budget is in the $200 million range, and looking at what we've spent so far and then looking forward, I would guess we're going to be probably in the spending the $150 million to $180 million range. We seem to always budget higher, but we understand how hard it is to make money, so we just don't plan it a year in advance, and then spend it. We look at it every month, if it's a good idea, good investment. For instance, in the energy sector, the CapEx dollars that are budgeted there, a lot of it has been put on hold. And when that sector comes back, and your guess is as good as mine when that's going to happen, when that does, we'll go ahead and spend a dollar. We look at it monthly, and that's just a guess, but we're budgeted for $200 million, and I don't think we'll spend near that.

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

Yes, and Luke, we're consistently, we've been a little bit under, but part of that's because when we put our budget together, for instance, if we're going to build a new facility, or if we're installing a large piece of equipment, we'll put the full dollar amount into the current year budget, but timing-wise it may spread into the following year. So that's also timing is a little bit of reason sometimes we're a bit under. But as to Jim's point, for the most part we're not pulling back on anything. And you had asked about the maintenance portion. And we think that's about $80 million a year, and the balance of this is growth related.

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

One other point, Luke, along those lines. For instance, in the automotive end, which we don't participate directly, the vast majority of our participation in there is through our toll processors, we're adding a new building in Mexico to support the big automotive down there. That was planned. However, due to the strength and the continued growing strength in that sector, there's a pretty good chance we'll be spending dollars into that, to support that market that weren't planned. So the $200 million won't be spent in total, but there may be additional dollars that will still stay under the $200 million, that we had not planned for in particularly strong sectors like automotive.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

That would be reallocating dollars that were going into energy originally into the automotive sector and aerospace for growth opportunities.

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

Yes and it's interesting, Jim mentioned on the toll processing side, and sometimes people ask us why we're so excited about it, when it's only 2% to 3% of our revenue dollars, but I think as we've talked about it, it's very nice business that we have there. And we for years have mentioned periodically that, through our probably 15 toll processing locations within the Company, they process more metal than we do in the rest of the Company. And even as we've continued to grow the rest of the Company, even with big additions like Metals USA, our toll processing businesses have continued to grow with the investments we've made in them, that they still are processing more tons than the rest of the Company.

Luke Folta - *Jefferies - Analyst*

Okay. That's great detail. Thanks a lot.

Operator

Thank you.

Operator

(Operator Instructions). And the next question is from Andrew Lane of Morningstar. Please go ahead.

Andrew Lane - *Morningstar - Analyst*

Hi, good morning.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Good morning.

Andrew Lane - *Morningstar - Analyst*

Congratulations on the solid execution this quarter. And along the lines of gross margin expansion, I'm curious as to what percent of your product you're currently buying via the import market relative to domestic producers? Has that figure changed since 1Q? And then for perspective going forward, what percent of imports would you typically buy in a more normalized mid-cycle pricing environment?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Well, we're right now at a more normalized, okay, buying pattern. We increased our purchases of offshore material, basically in the second half of last year, because our mills were very busy, and they basically said, we're busy enough that we don't need to institute programs to combat offshore material coming into some of the ports. But they're back in the game again. We prefer to buy from domestics. And typically we're somewhere between 3% and 5% of our purchases are offshore, okay, as a whole on all metals. And we're back to that pattern. I think, in the second half of last year, with material also arriving in the first quarter of 2015, that got up to about 8%. So it was about double what we would normally have done. And we don't like that. But the mills are back, and we're back down to our normal purchasing pattern of 3% to 5% coming in from outside of North America.

Andrew Lane - *Morningstar - Analyst*

Great. And then to change gears, I wanted to ask about automotive aluminum tolling, and how much of a growth area that is for you, without any major announcements since the F-150 changeover, where do you think that growth is going to come from? Is it more likely you'll take share from a business that already exists as you invest incrementally in your tolling business, or do you expect automakers aluminum adoption to really pick up in the coming years?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Well, we probably have three opinions over here, okay? I'll give you my quick one, and then Bill, you can jump in on this. The F-150 has grown more than even Ford Motor Company even realized how quickly it had grown. We thought we were going to do X number of million pounds of that, and now it's double than what our first expectations were. And there's other companies that I think that's going to change the picture of automotive, okay, and light truck. Just that's my personal opinion. Sticking pretty close to our toll processing operations, but why don't you give your opinion, Bill?

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

I agree. I think we're going to see more and more conversions. We read early on that some of the platforms were saying they weren't going to convert to aluminum, and there's a little bit of a back and forth in the market on what was going to be the product of choice. But I think more and more, we're hearing that they may not go all aluminum or aluminum intensive, but there are going to be more and more platforms converting parts to aluminum. So we think the outlook there is very, very positive.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Our largest toll process or operation reports in to Jim, and Jim, you're involved with that company daily, so their outlook?

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

It's strong. Just not in aluminum. They process a lot of steel too. I mean, aluminum seems to be the sexy trend right now. There's a lot of steel product running through those operations that go into automotive and appliance, and they just happen to be very good at it. Our growth, at 17 million-plus units of automotive, we seem to be, I think we're picking up far more of that share. So if that number grows, we'll grow up, we'll continue to go up, but I think from the long run, the part of the market that we've captured, I think we'll hold onto that and be growing more.

Andrew Lane - *Morningstar - Analyst*

Great. That's helpful commentary. Thank you very much.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Sure.

Operator

Thank you. Our next question is from Brett Levy, CRT Capital. Please go ahead.

Brett Levy - *CRT Capital - Analyst*

Hey guys, Gregg, David, Bill, Karla, good quarter. Can you talk a little bit about kind of the collapse of the aluminum Midwest premium, and whether or not that sort of is likely to be part of the reason that you're guiding down for the third quarter, just sort of inventory that has lost its value? And then I have one question to follow up on that?

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

Yes, really, as you know, we've seen a significant change, a drop there. Midwest premium, I think, as of this morning was about $0.084 or $0.085 down from a high, I think, of about $0.26 a pound. But for our guys, it really most of what we sell, that are tied to ingot pricing is going to more on the common alloy side, and some of the rod and bar soft alloy type products. And we turn that product very quickly, and we price the material on a spot basis. So it hasn't had a negative impact in terms of our margins. We are seeing that what it is doing, I think if you look at common alloy in particular, it was predominantly supplied by import product because of the gap between domestics and import. We now starting to see from that Midwest premium coming down, it is bringing the domestic mills more back into play. And so we're starting to see some shift there, where we'll shift away from import more toward domestic.

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

And the common alloy aluminum, the extent that the Midwest premium will affect us in pricing, even though our prices could be down a bit in Q3, it's a pretty small portion of our business, probably in the 4% to 6%, and from the standpoint of earnings guidance, we don't think that our guidance into Q3 from Q2 should be a surprise or unexpected. For years, the third quarter of the year is from a demand standpoint, down for service centers. Not just for Reliance, compared to 2Q. There are a lot of our customers who shut down, so we have fewer shipping days into those. So the normal trend is for demand to be down Q3 versus Q2. It appears from guidance that had existed out there, that people didn't seem to remember that when they put their guidance out there, but we've very consistently tried to remind everyone of that. And that's the norm. The other thing in the Q3 EPS guidance down from Q2 is, we tried to highlight and maybe didn't do a good enough job, that we had a big pickup in the catch-up LIFO income in Q2, we booked $32.5 million on our $80 million annual estimate, but in Q3 we would only be booking $20 million of that. So that's about a $0.12 hit change right there, just in Q2 to Q3 guidance. So we think our guidance is pretty consistent, and reflects us being able to continue to operate very well in the market, given the normal seasonal patterns.

Brett Levy - *CRT Capital - Analyst*

Karla, you get extra credit for giving more than a full answer to that question.

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

We wanted to make a few points there, Brett. And you gave us the opportunity.

Brett Levy - *CRT Capital - Analyst*

Thank you. The second one is on the CapEx front. It's always the buy versus build question. Obviously if $80 million of the either $150 million to $180 million or $200 million of CapEx is maintenance, the rest of it is growth. Can you talk about the principle areas by product or region that you guys are aiming at, and then are we kind of in a market right now, where you feel like some of the acquisition targets are full enough valued, that you sort of less in the M&A business, and believe that it's more economic to take market share by building?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Dave, do you want to hit the M&A?

Dave Hannah - *Reliance Steel & Aluminum Co. - CEO, Chairman*

Do you want me to do that first?

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Please.

Dave Hannah - *Reliance Steel & Aluminum Co. - CEO, Chairman*

Overall, Brett, on the M&A side, we've been reasonably busy looking at opportunities out there. It's not as active as it has been a couple years ago. But that's typical for this kind of a market. As Gregg mentioned earlier, the demand is pretty good. Outside of the energy side. But pricing really puts a damper on that. And people, business owners in our industry typically don't want to put their companies out there when they're not maximizing profit. So we are busy looking at opportunities. There are some out there, we will continue to do that. We're still in the M&A side. And I would expect that we will continue to grow in M&A, like we have in the past.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

And from the CapEx spending, as a percentage, the majority of our spending is going into the toll processing areas, in support of our automotive industry, as a percent of our total spending, where as Jim mentioned, we're building a new facility down in, just outside of Monterey, Mexico, to really put in there 80% for auto, another 20% for appliance. We're spending money, we built those two plants in Europe for our AMI operation. We're putting some money into our recent acquisition of our All Metal Services in Europe. But we're also spending money in some of our operations that support various industries outside of the energy sector. So it's pretty typical for what we're doing with the exception of we're not putting very much money at all into energy. But where we're spreading it out across North America and globally is pretty standard on what we do on a normal basis, burning equipment, laser equipment, some leveling lines, all of those things that we do every day everywhere.

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

This is Jim. The other sector that we have been spending money, and we'll continue to do that is in the non-residential construction sector. The customers, they want different things from us now. As they came out of a very difficult period for a long time, they come back now asking for us to do different things. For instance, instead of just buying truckloads of beams, and they do the work themselves, they're asking us that we deliver kits with beams with holes drilled in them, miter cuts, plates with etched, beveled, and all of that technology is available, and because of our strong balance sheet, we're able to invest in those things before the market even does come back, and we have done that, and it's paying off, and we'll continue to do that in the non-res and the other sectors that Gregg had mentioned.

Brett Levy - *CRT Capital - Analyst*

Great color. Thanks, guys.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Okay. Have a great day.

Operator

Thank you. We have no further questions in queue at this time. I would like to turn the conference back to management for any additional remarks.

Gregg Mollins - *Reliance Steel & Aluminum Co. - President, COO*

Okay. Well, listen, we'd like to say thank you for your support, and for participating in today's call. And we'd like to remind everyone that in September we will be in Boston, presenting at KeyBanc Capital Markets Basic Materials and Packaging Conference, and we hope to see many of you there. Have a great day. Thanks again for your participating on the call.

Operator

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