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RS - Q4 2017 Reliance Steel & Aluminum Co Earnings Call

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OVERVIEW:

Co. reported 4Q17 net sales of $2.38b and net income attributable to Co. of $301.4m or $4.09 per diluted share. Expects 1Q18 diluted EPS to be $1.90-2.00.

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PRESENTATION

Operator

Greetings, and welcome to the Reliance Steel & Aluminum Co fourth quarter and full year 2017 earnings conference call. (Operator Instructions) As a reminder, this conference is being recorded. I'd now like to turn the conference over to your host, Brenda Miyamoto. Thank you, you may begin.

Brenda Miyamoto - *Reliance Steel & Aluminum Co. - VP of Corporate Initiatives*

Thank you, operator. Good morning, and thanks to all of you for joining our conference call to discuss our fourth quarter and full year 2017 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, 2016 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 - *Reliance Steel & Aluminum Co. - CEO, President and Director*

Good morning, everyone, and thank you, for joining us today to discuss our fourth quarter and full year financial results.

2017 was a fantastic year for Reliance. Our strong annual gross profit margin of 28.7% is near the high-end of our target range of 27% to 29% and produced the highest gross profit dollars in our company's history of $2.79 billion. Continued modest growth in demand, along with the positive pricing environment throughout most of the year enabled us to grow our 2017 net sales by $1.11 billion over 2016, to reach $9.72 billion, the second highest ever for Reliance.

Our tons sold increased 3.8% in 2017 given a generally favorable macro environment that continued to improve throughout the year. Although metals pricing fluctuated throughout the year, the environment was positive overall resulting in a 9.1% increase in our average selling price in 2017 compared to 2016.

Our managers in the field did an excellent job managing pricing fluctuations, growing our value-added services to our customers, controlling expenses and managing working capital, all of which resulted in our second highest annual diluted earnings per share of $5.44, surpassed only by 2008.

Our $5.44 earnings per share amount is non-GAAP and excludes the $2.82 per share benefit from the impact of tax reform that Karla will discuss in a minute.

Our tons sold in the fourth quarter were down 4.6% from the third quarter of 2017 due to normal seasonality associated with the typical slowdown in shipping volumes resulting from fewer shipping days attributable to holiday-related customer closures. This reduction in tons sold was in line with our expectation of a 4% to 6% decrease compared to the third quarter. However, overall demand remains strong with our shipments up 6.3% compared to the fourth quarter of 2016.

We expect to see further demand improvement in 2018, as overall customer sentiment continues to improve in nearly all the end markets we serve, with longer term incremental upside possible from the administration's infrastructure plans.

Given Reliance's product mix, we are well positioned to benefit from an increase in infrastructure activity. The spring and summer months of 2017 were characterized by high level of uncertainty related to the pending Section 232 investigation, which contributed to a heightened level of imports in the marketplace, pressuring metal pricing. However, the improving demand environment, along with increased raw material pricing and trade-faced resolutions in the second half of the year supported higher pricing levels on nearly every product we sell. As a result, our 2017 fourth quarter average selling price was up 1.8% compared to the 2017 third quarter, ahead of our expectations of flat to down 2%.

Our higher selling prices resulted from continued mill price increases in the fourth quarter that have continued into 2018 and contributed to our stronger-than-anticipated earnings.

On a year-over-year basis, both shipment levels and average selling prices were up for all of our commodity categories including stainless, carbon, aluminum and alloy.

Since October of 2017, there have been more than 10 price increases announced for carbon steel products. These price increases were not fully reflected in our fourth quarter results, and as such, we expect them to have a positive impact on our first quarter 2018 results.

Turning to our balance sheet. We are comfortable with our inventory position, which supports our ability to provide just-in-time delivery to our customers, often in 24 hours or less.

For the year, we achieved an inventory turn rate of 4.5x, consistent with 2016. Inventory management will always be a key focus at Reliance, as we believe that maintaining efficient inventory levels is one of the main drivers to our industry-leading gross profit margin.

Other crucial components include pricing discipline and value-added processing capabilities. Together, these factors have enabled us to generate significantly more gross profit dollars in recent years that dropped to our bottom line.

In regard to value-added processing, we will continue to make strategic investments in equipment and facilities to drive organic growth. Our 2018 capital expenditure budget is $225 million with the majority of these investments growth related.

We also expect to continue to grow and drive our earnings higher by acquiring well-run businesses that expand our existing footprint, complement our diversification of products and services or increase our value-added processing capabilities. While it is still early in the year, we are seeing an increase in the number of acquisition opportunities in the market in 2018. As a result of increased profitability and effective working capital management, we generated $399 million in cash flow from operations in 2017.

To support our growth, we spent $161.6 million on capital expenditures and completed the acquisition of Ferguson Perforating Company in October of 2017. Ferguson is a niche player in the perforated metals market providing highly engineered specialty products, and has been operating in line with our expectations and was accretive to our 2017 earnings.

We also paid $132 million in cash dividends to our stockholders and repurchased $25 million of our stock in 2017. In addition, effective for the first quarter of 2018, we increased our regular quarterly cash dividend by 11.1% to $0.50 per share or an annual dividend of $2 per share. Reliance has paid regular quarterly dividends for 58 consecutive years, and this is our 25th dividend increase since our 1994 IPO.

These stockholder return activities demonstrate the confidence our board and management team has in our business model and our outlook.

In summary, 2017 was an exceptional year for Reliance. We are encouraged by the positive pricing momentum and improved demand environment that we saw in 2017 that has continued into 2018. In addition to higher metal pricing, our strong gross profit margin enabled by the fantastic performance of our managers in the field allowed us to generate higher earnings.

While some uncertainty still exists in the market, we believe that overall customer sentiment and demand are continuing to substantially improve, and we anticipate that an ongoing reduction in imports will continue to support higher metal pricing. We believe these factors as well as the potential for meaningful infrastructure spending will increase metal demand and pricing, which we expect will enhance our profitability and strong cash flows.

Over the past 5 years, we have invested $2.26 billion to further our growth through capital expenditures and acquisitions, and we have returned over $1 billion to our stockholders through dividends and share repurchases. We look forward to returning even greater value from these investments and continuing our strong stockholder return activities.

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

James D. Hoffman - *Reliance Steel & Aluminum Co. - COO and EVP*

Thanks, Gregg, and good morning, everyone. First off, I would like to recognize our folks in the fields who contributed to our strong 2017 results. We thank you for your hard work and dedication that helped us achieve another year of strong operational performance.

Now, I'll discuss demand and pricing of our carbon steel and alloy products as well as our outlook on certain key end markets we sell those products in to. Bill will then address our aluminum and stainless steel products and their related end markets.

Demand for automotive, which we serve, is mainly through our cold processing operations in the U.S. and Mexico, remained strong throughout the fourth quarter. We continue to make investments to expand our facilities and equipment to increase our capacity to both carbon and aluminum processing for automotive market.

Our facility in Monterrey, Mexico has now been operational for a full year, and continues to perform in line with our expectations. In addition, we completed construction of a new facility in Kentucky in the second quarter of 2017 to support increased demand for both aluminum and steel processing in that region.

In the fourth quarter of 2017, we were operating at approximately 50% of expected capacity in this location, and we look forward to continuing to ramp up the Kentucky facility processing capacity in coming months.

Demand in heavy industry, which includes railcar, truck trailer, shipbuilding, large manufacturing, tank manufacturers and wind and transmission towers began to improve from lower levels in the second half of 2017. In particular, we continued to experience an increase in construction equipment spending.

Looking ahead to the first quarter of 2018, we are optimistic that demand in heavy industry will continue to strengthen.

Demand in nonresidential construction market, including infrastructure, grew at a steady rate throughout 2017, but still remains far below peak levels experienced in 2006. We are cautiously optimistic that domestic infrastructure spending will continue to improve with incremental upside possible from federal infrastructure spending.

Extreme winter weather conditions in the east also played a small role in delaying certain fourth quarter nonresidential construction projects pushing them into the first quarter -- or first half of 2018. We remain well positioned to support increased volume in our existing footprint as this end market continues to gradually improve.

Demand for the products we sell into energy market, which mainly is oil and natural gas, steadily improved in each successive quarter in 2017. We continued to see growth in rig counts and drilling activity with mill lead times extending and completion activity gaining strength.

Importantly, our businesses servicing the energy market contributed positively to our earnings in every quarter of 2017 after hitting what we believe was the bottom in 2016. The increased activity in energy is an encouraging sign. We are well positioned to support demand growth as this market continues to recover, which is in line with our expectations for a stronger 2018.

Mill pricing for carbon steel products, we sell into these end markets, was stronger than we had anticipated in the fourth quarter.

As we noted on our last call, we experienced fairly significant price reductions for certain of our carbon steel products late in the third quarter that we expected would negatively impact our average selling price in the fourth quarter. However, as Gregg had mentioned, there were a number of price increases for carbon steel products announced throughout the quarter, all of which were supportive. As a result, we were able to maintain our pricing and pass a portion of the announced pricing increases along to our customers during the fourth quarter, before receiving the higher cost metal into our inventory. This resulted in a slight improvement in our gross profit margin for carbon steel products versus the prior quarter.

So far, in 2018, there have been continued mill price increases for carbon steel products that are being supportive. And we are optimistic there is room for further increases due to an overall reduction in import offerings, the pending Section 232 decision, higher demand and increasing raw material prices.

Price for alloy products has been improving, as demand in energy market continues to recover. We believe that further improvement in activity levels in the energy market should help support increased pricing going forward.

In summary, we are confident about our positive 2018 outlook as it relates to both demand and pricing trends. We are experiencing continued strength in our tolling businesses, servicing the automotive industry and we are pleased to see steady increases in demand for energy, nonresidential construction and heavy industry markets.

We remain committed to investing in value-added processing equipment for the businesses that support these end markets, and believe we are well positioned to absorb increased volumes in our existing footprint and cost structure as these markets continue to strengthen.

Thank you for your attention today. I will now hand the call over to Bill to comment further on our nonferrous markets. Bill?

William K. Sales - *Reliance Steel & Aluminum Co. - EVP of Operations*

Thank you, Jim. Good morning, everyone. First, I would also like to thank our folks in the field for their excellent operating performance in 2017. Thank you all for a job well done.

I'll now review pricing and demand for our aluminum and stainless steel products, including the key industry trends in these markets we sell the products in to. Aerospace demand remained strong in the fourth quarter. Today, lead times for aluminum aerospace plate are steady compared to the third quarter at approximately 7 to 10 weeks. The backlog for orders of commercial planes is strong, and we expect build rates to continue to improve in 2018, led by single-aisle planes.

We continue to see increased activity for many of our defense customers. Our production activity related to our participation in the 5-year $350 million Joint Strike Fighter Program that began in 2017 is now fully ramped, and we expect production levels to remain fairly steady for the foreseeable future.

Further, our entry into the aerospace market in India through our All Metal Services subsidiary is now expected to become operational by the end of first quarter of 2018. We maintain our positive outlook for the aerospace market and look forward to increasing our market share in this area as overall demand continues to grow.

As it relates to the semiconductor market, global activity remains strong. Because of the optimistic global growth outlook and our strong position in this market, particularly in the U.S. and Pacific Rim regions, we are in the process of expanding our operation in South that supports the semiconductor industry and adding new manufacturing capacity in the U.S. and China to support higher production needs. We maintain a positive outlook for the semiconductor market in 2018 based on solid demand trends and an encouraging outlook from our customers.

Moving on to pricing. The majority of our sales into the aerospace market consist of heat-treated aluminum products, especially plate as well as specialty stainless steel and titanium products. Demand for heat-treated aluminum plate has continued to improve. The most recent price increases for aluminum heat-treated products that took effect in January have been fully supported by the mills.

Looking ahead to the first quarter of 2018, we are optimistic that aerospace pricing will continue to strengthen. Most of our common alloy aluminum products are sold to sheet metal fabricators that support a variety of end markets. Demand for common alloy aluminum sheet remained relatively stable in the fourth quarter with lead times remaining at 8 to 12 weeks.

Currently, we are seeing demand strengthen with lead times extending to 12 to 16 weeks. From a pricing standpoint, the announced conversion price increases for common alloy aluminum sheet have support. The conversion price increases, combined with an increase in the Midwest spot price should lead to higher prices for common alloy aluminum sheet in the first quarter.

Lastly, demand for our stainless steel flat products, which are primarily sold into the kitchen equipment, appliance and construction end markets, has remained solid. Our average selling price for stainless steel products increased during the fourth quarter, driven primarily by September and November price increase announcements, each a 2 point reduction of the discount for commodity stainless flat-rolled products, which were supported in the market.

Demand for stainless steel remained strong. The January price increase of another 2 point reduction in discount has domestic support, and we believe there is a potential for further price increases.

Thank you for your time and attention today. With that I'll now turn the call over to Karla, to review our fourth quarter 2017 financial results. Karla?

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

Thanks, Bill, and good morning, everyone. Our net sales in the fourth quarter of 2017 were strong at $2.38 billion, up 15.3% from the fourth quarter of 2016 with our tons sold up 6.3% and our average selling price per tons sold up 8.8% year-over-year.

Compared to the third quarter of 2017, our net sales were down 3% with tons sold down 4.6% and our average selling price up 1.8%.

As discussed previously, the pricing environment in the fourth quarter of 2017 was stronger than we had anticipated. The combination of overall higher prices and increased shipping levels across all of our commodity categories resulted in $315 million more sales dollars in the fourth quarter of 2017 compared to the fourth quarter of 2016.

For the full year, our net sales were the second highest in our company's history at $9.72 billion, up 12.9% from $8.61 billion in 2016. Tons sold were up 3.8% and our average selling price was up 9.1% compared to 2016.

Our gross profit margin in the fourth quarter of 2017 was 28.6%, down from 29.8% in the fourth quarter of 2016 and up from 28.0% in the third quarter of 2017. Our full year gross profit margin was 28.7% in 2017 compared to 30.1% in 2016. We are proud of our 2017 gross profit margin that was at the high-end of our target range of 27% to 29% and resulted in record gross profit dollars of $2.79 billion.

As a result of higher metal prices in 2017, our year-end cost of inventory on hand was higher than at the end of 2016. This resulted in a net LIFO inventory valuation charge or expense of $30.7 million for 2017 compared to a credit adjustment or income of $27.4 million in 2016.

Our actual LIFO expense for 2017 was $73.3 million, but was offset by $42.6 million from the full reversal of our lower of cost or market reserve.

At this time, we anticipate metal prices will increase in 2018, which means, of our year-end inventory cost on hand will be higher than at the end of 2017. As a result, we currently estimate LIFO expense of $80 million for the 2018 year or $20 million per quarter.

As in prior years, we will update our expectations quarterly based upon our inventory cost and metal pricing trends.

As a percentage of sales, our fourth quarter SG&A expenses were 20.2%, down from 21.4% in the fourth quarter of 2016 and up from 19.2% in the third quarter 2017.

For the year, our SG&A expenses were 19.6% of sales, down from 20.9% in 2016. The year-over-year decreases were primarily due to higher selling prices in 2017 compared to 2016, which increased our net sales.

Interest expense for the year decreased by $10.7 million in 2017 compared to '16, mainly due to the November 2016 refinancing of our 6.2% senior notes with bank debt. In 2017, we recorded $4.2 million of impairment charges compared to $52.4 million in 2016 that were mainly related to our businesses servicing the energy end-market. These amounts are included in our non-GAAP adjustments, which can be found in our earnings release issued earlier today.

Our non-GAAP pretax income for 2017 was $582 million, up $87.2 million or 17.6% from 2016, resulting in a pretax margin of 6.0%. The enactment of the Tax Cuts and Jobs Act, or tax reforms, in December 2017 resulted in a provisional income tax benefit of $207.3 million in the fourth quarter or a benefit of $2.81 per diluted share.

Tax reform impact reflects a one-time provisional tax on accumulated overseas profits and the revaluation of deferred tax assets and liabilities. Excluding the impact of tax reform, our effective tax rate would have been 20.1% for the fourth quarter and 29.1% for the full year of 2017.

While we will continue to assess the impact of tax reform, we currently expect our effective tax rate for 2018 to be in the range of 24% to 25%, reducing our annual cash taxes by approximately $50 million.

Net income attributable to Reliance for the fourth quarter of 2017 was $301.4 million or $4.09 per diluted share. Excluding the impact of tax reform, net income was $94.1 million or $1.28 per diluted share.

Non-GAAP earnings per diluted share were $1.22 compared to $0.84 in the fourth quarter of 2016 and $1.32 in the third quarter of 2017.

For the full year, net income attributable to Reliance was $613.4 million or $8.34 per diluted share. Excluding the impact of tax reform, net income was $406.1 million or $5.52 per diluted share.

Non-GAAP earnings per diluted share were the second highest annual diluted earnings per share in the company's history at $5.44 compared to $4.48 in 2016.

Turning to our balance sheet and cash flow. As a result of our higher average selling prices and shipment levels along with our strong gross profit margin and effective working capital management, we generated $399 million in cash from operating activities during 2017. We invested $161.6 million in capital expenditures, spent $37.8 million for an acquisition, repurchased $25 million worth of our common stock at an average cost of $74.27 per share and paid $132 million in dividends to our stockholders, while also paying down debt.

At December 31, 2017, our total debt outstanding was $1.91 billion, resulting in a net debt-to-total capital ratio of 27.2%. Our net debt-to-EBITDA multiple was 2.0x, in line with our targeted financial profile. As of the end of the fourth quarter, we had over $900 million available on our $1.5 billion revolving credit facility.

As for our outlook, given the strong start to 2018, we are optimistic with regard to business activity levels and metal pricing in the first quarter of 2018. We estimate that our tons sold will be up 6% to 8% in the first quarter of 2018 compared to the fourth quarter of 2017. Further, we expect our average selling price in the first quarter of 2018 will be up 4% to 6% compared to the fourth quarter of 2017 as recent increases in metal pricing have been supportive thus far.

As a result, we currently expect earnings per diluted share to be in the range of $1.90 to $2 for the first quarter of 2018.

In closing, we are very pleased with our overall financial and operational performance in 2017, which is directly attributable to outstanding execution by our managers in the field. Our strong balance sheet provides us the foundation to continue executing our growth and stockholder return activity. Our repurchase of $25 million of our common stock during the fourth quarter of 2017 and the 11.1% increase in our quarterly dividend effective in the first quarter of 2018 reflect the confidence our board and management team have in our outlook and ability to execute in the current favorable environment for both demand and pricing.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Chris Terry from Deutsche Bank.

Christopher Michael Terry - *Deutsche Bank AG, Research Division - Research Analyst*

First question I had is just on the CapEx. I think, you said $225 million for 2018. Are you able to talk through the different growth projects? And how that CapEx is expected to be split?

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

As far as our growth initiatives of the $225 million that we reported, about 59% of that, or $132 million, is in growth-related initiatives.

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

That's made up of quite a few different projects, Chris. We've got -- a lot of it's based on growth through new value-added processing equipment so we can expand our capabilities in various of our existing operations, but it's many different projects. For us -- we're different -- we don't have $100 million individual CapEx projects. So it's quite a bit spread across our company.

James D. Hoffman - *Reliance Steel & Aluminum Co. - COO and EVP*

Chris, this is Jim. And a lot of those dollars go into new operations so we can get closer to our customers. As we said before in other calls, our customers are asking us to do a lot more, and sometimes we need to expand our locations or actually build a brand-new location closer to them. As Karla mentioned, lot of higher technology, better tolerance equipment that we're adding. So there is a lot of big projects, a lot of smaller projects, as Gregg said, 59% of that $224 (sic) [$225] million was what we would consider growth, and the rest was kind of maintenance replacement.

Christopher Michael Terry - *Deutsche Bank AG, Research Division - Research Analyst*

Okay, sure. And then just on the M&A outlook, you commented on that a little bit before. But given that the pricing backdrop in the overall sector seems quite strong, can you just comment on the ability to actually execute deals at the moment? I assume companies are not really willing to sell given the positive environment.

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

I don't know about that. Our activity, okay, has actually picked up here in 2018 as compared to 2017. So obviously, there is some move on sellers' parts to get themselves lined up with the potential acquirer. So our activity is better there. That doesn't mean we're going to be knocking home runs out. We have to take a look at each one on its own merits, look at their profitability, management teams, cultures, et cetera, et cetera. But from an activity point of view, we're actually encouraged by what we've seen since the first of the year.

Christopher Michael Terry - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. And then, the last one from me just on I think you talked a bit about the stainless market a bit. Can you just elaborate on the outlook there? And then also specifically on the plates market where there has been strong price rises, I guess, since the October time frame of last year. Can you just chat through that market a little bit as well?

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

Jim, do you want to do plates first?

James D. Hoffman - *Reliance Steel & Aluminum Co. - COO and EVP*

Yes. On the carbon plate side, demand is looking good. A lot of price increases have been coming through. Alloy up until yesterday, there is a $50 price increase based on demand, some input charges. The mills are busy. Last figure I saw, their capacity rating is in the 74.5% range, which is good for them. I'm sure they'd like to be busier. One big uptick, [the mill actually] has people on controlled-order entry, which is a sign of good demand and some supply issues. So on the plate demand side, it is better than it was.

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

Chris, very similar story on the stainless side. Demand was solid all through 2017. We've seen demand strengthen and lead times have moved out from 6 to 8 weeks to about 8 to 10 weeks. The January increase seems to have support. There seems to be more pricing discipline in the market based on the strengthening demand. So the outlook there is very positive.

Operator

Our next question is from Martin Englert from Jefferies.

Martin John Englert - *Jefferies LLC, Research Division - Equity Analyst*

Wanted to see are you able to discuss what your 2017 tolling volumes were? And how that's changed may be from the previous year as well as changes in participation within carbon and aluminum? And how you may have grown some market share there?

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

On the tolling business, our tons sold and we've said this for a few years now, we actually process smaller tons in our tolling businesses than we sell or tons sold for the rest of the company. So it's a substantial amount of volume that we're handling there. We've seen that with the investments we've made to grow our capacity in both carbon and aluminum processing. In our tolling businesses, we do see those tons continue to increase year-over-year. And we are seeing a bit more of a mix shift to aluminum from carbon, but the aluminum tolling that we've had has been a new business for us. So we didn't lose carbon business and have the aluminum in place of that. So we are seeing that aluminum tolling business continue to grow for us. We've, as we said, made some recent investments there. And based on discussions, we expect the aluminum business to continue to improve, at the same time the carbon steel processing is still very important for us. And we continue to see solid business out of the carbon side as well.

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

The new plant that we've built in Kentucky was specifically brought onboard because of aluminum usage in that particular area. So our customers ask us to be closer to them, which we've done, and I think, it's working. Which is running at capacity-wise, Jim?

James D. Hoffman - *Reliance Steel & Aluminum Co. - COO and EVP*

50%.

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

50%. So we've got ways to go there, but we've got strong backlogs for that. But we haven't seen much of a drop-off on our carbon steel usage through our toll processing as in operations, other than the fact that some of the builds have had some outages and what not. But on a same-store basis, regular volume basis, we really haven't seen a drop in our carbon steel, but we've seen a vast improvement in our aluminum processing by far.

Martin John Englert - *Jefferies LLC, Research Division - Equity Analyst*

Okay, excellent, and thanks for all the detail there. And if I could one other. Maybe if you could provide some comments regarding the company's leverage to nonresidential construction, infrastructure, recalling some of the prior acquisitions such as PNA Group and others that may have expanded capabilities since the last up cycle?

James D. Hoffman - *Reliance Steel & Aluminum Co. - COO and EVP*

This is Jim. We're seeing nice demand. It's kind of a slow burn up. Over the last 2 or 3 years, we've had a nice gradual increase in nonresidential construction. We anticipate that to continue through 2018. We still have a long way to back to the top, which was probably 2006, 2008 timeframe. And if it does get up there, we're well positioned to take on additional work without adding a lot of things other than probably some couple of bodies that are brick and mortar and the equipment is in good shape there and we'd continue to upgrade that throughout the recession. So we're in good shape for that.

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

Roughly about a third of our business is in the nonresidential construction, and that also includes infrastructure. So it's a big part of our overall mix. And we have had, as Jim just pointed out, some steady improvement over the past 2 or 3 years. But we've got, as Jim said, we've got equipment in place, facilities in place, brick and mortar, et cetera, et cetera, that we can take a lot more tonnage and add very little expense to our bottom line.

Martin John Englert - *Jefferies LLC, Research Division - Equity Analyst*

Where do you think the nonresi infrastructure was as a percentage of overall sales during the last up cycle?

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

Yes. It's hard for us to tell because of our customer base and where our product is going. So we kind of look at our product mix and just businesses we have out there. But as Gregg said, we generally think it's about a third of our business on a dollars -- percent of revenue dollars. I don't -- we really can't get much more granular than that.

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

The (inaudible) about nonresidential construction and infrastructure growing is that just -- it's the largest consumer apartment steel products of any industry in the country. So it drives all the carbon steel products. And with that, generally, we see price increases because demand is so much stronger on all the different products.

Operator

Our next question is from Novid Rassouli from Cowen and Company.

Novid R. Rassouli - *Cowen and Company, LLC, Research Division - VP*

Sticking with nonres, can you just give us a sense of how things are tracking relative to this time last year? And does the story remains kind of the same gradual incremental growth, but nothing kind of dramatic or off the charts without some sort of action from the current administration?

James D. Hoffman - *Reliance Steel & Aluminum Co. - COO and EVP*

Yes, I agree with that. It feels about the same as it did last year. It's incrementally better. It's positive. We're getting the quotes we think we earned. As we said in the past, we're not the guys that does the 40, 50 story building. We're the guys that does the 4-story assisted living home or the college campus expansion. That's our sweet spot. And that's what we continue to see. That's what we continue to get. We guessed right. We know when you come back from the recession, customers are going to ask us to do different things. We invested in the value-added equipment then. And as they come online, we're able to do more for them, which helps our bottom line. So yes, I agree with your assessment. It kind of feels like last year at a nice gradual pace.

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

We're pretty optimistic, and certainly it would be very, very helpful if the administrative stuff got in bed and started throwing some cash out in addition to private sector to invest as well. But that would have a very, very positive impact on us. And we've all been waiting for that for about a year. And hopefully, that will be -- we'll see something happen that we can actually put our fingers on it in the next few months, but nonetheless, that would have a very positive impact. But as it is, today, as we're sitting in this room, some of the most profitable companies we have in the corporation are committed to the nonresidential construction market.

Novid R. Rassouli - *Cowen and Company, LLC, Research Division - VP*

Got it. Very helpful. And then switching gears to oil and gas side. I was just wondering if you guys can be a little bit more specific with respect to maybe the products that you're seeing kind of quoting and overall activity picking up for? If there is any standouts? If it's across the board? Just trying to get a sense of how this kind of recovery that began in 2017 is starting to look as we get further along?

James D. Hoffman - *Reliance Steel & Aluminum Co. - COO and EVP*

Yes, I can take that. It's kind of across the board. You have to remember, we're not in line pipe or OCTG. Those are the 2 big heavy hitters that get a lot of attention. We're in the drilling and the completion side. And we've got companies that do a lot in completion and a lot in drilling and everything in between. So the products that are doing well, so far have been mostly on the drilling side. But we are seeing more and more activity in the completion side. So it's every -- it's product, everything from heavy wall, alloy tubing to alloy bars to a lot of different higher alloys, higher-priced material that goes into everything from drill collars to Christmas trees to pump jacks.

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

Primary alloy is bottom line on the carbon steel end.

Operator

(Operator Instructions) Our next question is from Phil Gibbs from KeyBanc Capital Markets.

Philip Ross Gibbs - *KeyBanc Capital Markets Inc., Research Division - VP and Equity Research Analyst*

My question was on the operating expense. I think we noticed the fourth quarter expenses were up quarter-on-quarter when you had seasonally weaker volumes. I would assume some of that is bonus accruals because you guys had a great year. But can you talk about the baseline operating expense environment, excluding what the comp may have -- comp component may have been, just because we're noticing that freight, other costs of doing business are higher? And then we're also trying to get a good run rate in terms of what we should be using for the first quarter.

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

Phil, so on the SG&A expenses, fourth quarter is usually not as predictable as the other quarters of the year. It is just because year-end true ups and things. But overall, because we do have in the fourth quarter, holiday pay during that quarter. So even though we're not shipping as much, we're still paying our employees for the holidays. So that always effects the fourth quarter a bit. Other than that, certainly, yes, some of the freight costs are up, but -- and that hits our SG&A expense line, but we also pass -- that's part of what we charge our customers for, that's one of the services we provide, is delivering our product to them. And the majority of our delivery is done on our own trucks. So it's with our drivers that are our employees. So I think, we're not seeing the squeeze that you hear from some other companies in our industry or outsourcing it more to third parties. But certainly, fuel and some of those items are up. But again, in our model, we try to pass that through to our customers. So it is the SG&A line could be a little higher, but the revenue line should also be a bit higher to cover that. Run rate going forward, if you look at like Q1, Q2 of last year, those are probably better normal type of SG&A run rates. We do -- we did again in 2018 as we have done consistently is provide wage increases to our employees. So you should expect our Q1 '18, or quarterly run rate in '18 to be a bit higher than in '17, just because of the inflationary factors related to wage increases, healthcare increases, et cetera.

Philip Ross Gibbs - *KeyBanc Capital Markets Inc., Research Division - VP and Equity Research Analyst*

Okay. That's helpful. And I noticed in your, I think your nonferrous script, Bill, you had talked about some of the business that you're setting up outside the U.S., I think in Korea and maybe China. And I know semiconductor spending, I think, we've talked in the past, can be extremely volatile. It can be very strong at the good times and very weak at the bad times. So I'm just trying to balance out the timing of the investment that you all are making? And then what gives you confidence that you're making at the right time given where the cycle is?

William K. Sales - *Reliance Steel & Aluminum Co. - EVP of Operations*

Yes, Phil, you're right. It does tend to be somewhat volatile, but the outlook is really positive. We saw last year on the semiconductor side, it was extremely strong and that looks like it's going to carry through this year. The investments that we're making in Korea and China and some here in the U.S. are focused on the semiconductor market. And then the other investment, the new facility is All Metal Services in India, which is aerospace focused. And the outlook is very positive for all of that, which is one reason we're very comfortable making those investments.

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

And in South Korea, Phil, we've been in that market, I think, about 15 years. So we're not in new place. We're not just jumping in because of the current outlook. We've been there in steel, we know that market pretty well. And we've been in China for a while now as well. So we feel comfortable making those further investments in those operations.

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

Basically, in South Korea, we've been there, as you pointed out, about 15 years, but we're basically doubling the size of our production capacity there, right, okay. So it's a good investment, but it's paying dividends as we speak. And I think, we're putting the money in at the exact right time.

Philip Ross Gibbs - *KeyBanc Capital Markets Inc., Research Division - VP and Equity Research Analyst*

Are these for new customers or existing customers? I'm just trying to gauge the pole.

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

Both, both. We work for some major customers that are expanding their operations. And there are some new business in that also. But the vast majority is on existing customers expanding their production.

Philip Ross Gibbs - *KeyBanc Capital Markets Inc., Research Division - VP and Equity Research Analyst*

And this is for industrial aluminum plate for the most part? Is that what we're talking about here?

William K. Sales - *Reliance Steel & Aluminum Co. - EVP of Operations*

Some of that investment is the electro polish tubing that goes into the vacuum chamber industry. So it's not all plate driven. And the major investments that we're talking about in Korea and China are more tubing oriented in play.

Philip Ross Gibbs - *KeyBanc Capital Markets Inc., Research Division - VP and Equity Research Analyst*

Not stainless steel.

William K. Sales - *Reliance Steel & Aluminum Co. - EVP of Operations*

No.

Operator

Our next question is from Aldo Mazzaferro from Mazzaferro Research.

Aldo Mazzaferro

I got 2 questions, Gregg. The first one on the pricing angle. You mentioned your forecast on pricing, 4% to 6% higher in the sequential quarter. That will probably trail some of the indexes. I'm wondering, are you able to pass on all the dollar for dollar increases that you're getting at this time on the tons?

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

Yes. We will. But the main question is, how much can we get capture like immediately upon announcement. As you know, the vast majority of our business, in particular, on carbon steel products, okay, spot business. So very little contractual business on that. So we literally take the position that when the announcement is made, as Jim just mentioned, $50 a ton on carbon steel plate was -- we learned about yesterday. That $50 a ton will be on our price books effective this morning. We'll get that with -- our work average order size is little over $1,600 per order. So obviously we're doing business with the tremendous amount of job shops, smaller companies placing smaller orders. And those companies, okay, whether you're charging them $1,600 for an order or $1,650 or $1,700 it's not that big of a deal. So we can get a lot of those price increases at time of announcement. The more sophisticated companies, the large ag producers and what not, they recognize the fact that we've got 3 months on our core inventory position. And it's not likely that they're going to pay at the time of announcement, but we'll get it, okay. It's just a matter of do you get it today or do you get it in 60 days from now. But at the end of the day, we get it.

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

And that's where, Aldo, you mentioned potentially trailing the indexes. And one of the things you have to think about is our product mix, and factor that in when you think about whatever indexes you're looking at and what Gregg was talking about, some of the mill increases that are effective in Q1, we already got in Q4 of '17. So depending how you're comping us against the indexes out there, you got to take that as a consideration also.

Aldo Mazzaferro

Great. I was just kind of thinking that you're always going to be trailing a little bit, right. So the things we're seeing in the first quarter now in terms of announcements, means you're probably going to have some catching up to do into the second quarter too as you go. But my bigger question is, Gregg, do you think the market -- do you think the steel market can take any more trade protection? Given the fact that we're facing some lower imports now, we've got demand picking up and you have President Trump with Section 232 potential in front of him. But other than big friendly countries and maybe semifinished steel, what could you do without causing major disruption to the market? I'm just wondering, if you think it's going to -- do you think the market is at risk if he does nothing?

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

Let me tell you what I know about the 232 case. I don't know anything about 232. I'm so confused by the son of a gun, it's supposed to go into effect in June, didn't go end of June. It's supposed to go effect in August, it's supposed to go into effect, who the hell knows, okay. All I know is that Jim says we don't run our company based on hope. We run it based on what we know. And all we know is that imports are lower. We think they're going to be -- they're going to continue to go down somewhat, not probably at the percentage that they went down in, basically, the fourth quarter of the year, okay. But we think there's room for imports to continue to decline. We're hopeful that there is more price increases, because we like prices higher than lower. But at the same time, we are -- we hope that the mills use some discipline so the spreads don't become so great that imports come in more. But if you want to get a really good answer to your 232, you better call the White House. You're barking up the wrong tree here.

James D. Hoffman - *Reliance Steel & Aluminum Co. - COO and EVP*

And Aldo, just one thing to add, regardless of what they're calling, there's countries who are cheating. I mean, there's loans on the books, and they're flat out cheating and dumping product into The United States. That's a fact whether we decide to enforce the laws that're already on the book, or add new laws that they're cheating and dumping product in to the country.

Operator

Our next question is from Phil Gibbs from KeyBanc Capital Markets.

Philip Ross Gibbs - *KeyBanc Capital Markets Inc., Research Division - VP and Equity Research Analyst*

I think I just had a follow-up question on the LIFO and Karla, in terms of what your assumptions are behind that. Are you assuming that your pricing guidance levels for Q1 basically hold through the course of the year?

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

Yes, also, we do have to make an estimate for the full year. So the $80 million expense is based on our current estimate with our outlook. So we do think that current pricing will hold and that there is room for further upside. Certainly, we've been in this business a long term. Prices go up and they go down. But our $80 million, we think does leave a little room for some fluctuation throughout the year. But overall, we expect our prices at the end of the year to be higher than they were at the beginning of the year. When we kind of compare, the $80 million estimate is -- of expense is a little more than our actual 2017 expense of $73.3 million. So you can kind of use that as a guide of what pricing did in '17 to be what our expectations are for '18.

And sorry, Phil, and also remember that our inventory cost on hand at December 31, '17, which is our starting point, because the time lag doesn't -- did not reflect all the price increase announcements. So some of the price increase LIFO effect will get in '18 is based on Q4 '17 price increases as well.

Operator

This concludes the question-and-answer session. I would like to turn the floor back over to Mr. Mollins for any closing comments.

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

On behalf of our team here at Reliance, I'd like to thank all of you for participating in today's call. I'd also like to extend my gratitude to all our employees, customers, suppliers and stockholders for their continued support and commitment to Reliance. We look forward to a successful year ahead, and have a great day. Thank you.

Operator

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