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PRESENTATION

Operator

Greetings, and welcome to the Reliance Steel & Aluminum Co.'s Second Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Brenda Miyamoto.

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 second quarter 2018 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, 2017, 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 & Director*

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

We had an outstanding second quarter. Pricing momentum continued to build throughout the second quarter, resulting in yet another quarter of milestone achievements, of which we are extremely proud. We generated record quarterly net sales and gross profit dollars for the second consecutive quarter. Our record sales of $2.99 billion, coupled with our strong gross profit margin of 30.7%, produced the highest ever quarterly gross profit dollars in Reliance's history of $917.5 million. The continued strong execution by our managers in the field, supported by the positive business environment, drove record quarterly pretax income of $306.6 million, and generated the second highest quarterly earnings in our company's history at $3.16 per diluted share, exceeded only by the fourth quarter of 2017, which included a significant benefit from tax reform.

The metal pricing environment was significantly stronger than we had anticipated, gaining strength as the second quarter progressed, with prices increasing in each month of the quarter across all our major commodities.

Solid demand, coupled with ongoing Section 232 activity, drove metal price increases on almost every product we sell. As a result, our average selling price per ton sold increased 9.6% compared to the first quarter of 2018, exceeding our expected range of 5% to 8% increase. Compared to the second quarter of 2017, our average selling price increased 18.1%.

The favorable pricing environment in 2018 has allowed us to generate higher FIFO gross profit margins, as we consistently pass through higher metal prices prior to receiving the higher cost metal into inventory. This supported our second highest FIFO gross profit margin of 32.8% achieved in the second quarter of 2018, exceeding our expectations.

Prices have generally remained stable in the month of July, which we expect to continue through the third quarter with the exception of slight price increases anticipated for both carbon flat-rolled and plate.

The demand environment remained solid throughout the second quarter. Our tons sold were down 0.7% from the first quarter of 2018, within our expected range of up 1% to down 1%. We also anticipated volume pressure in the second quarter due to prebuying activity by certain of our customers in the first quarter of 2018 in response to the rapid price increases and concerns about metal availability, especially for carbon steel flat products.

Demand trends have remained strong thus far into the third quarter, subject to normal seasonality associated with the customary decline in shipping volume due to customer shutdowns and vacation schedules.

Through our continued effective inventory management, we achieved an inventory turn rate of 4.4x based on tons. We remain comfortable with our inventory position, which enables us to achieve an industry-leading gross profit margin as well as provide just-in-time delivery to our customers often in 24 hours or less.

In regard to capital allocation, we continue to focus our 2018 capital expenditure budget of $225 million on strategic investments in equipment and facilities to drive organic growth and expand our value-added processing capabilities. Our customers value our high-quality products and services as well as our quick turnaround and delivery times, all of which supports our ability to increase our gross profit margin and earnings.

To support further growth, we continue to look for well-run businesses that complement our diversification of products, services and geographies and/or increase our value-added processing capabilities. The pipeline for acquisition opportunities remains strong and we are seeing an increase in the number of opportunities in the market.

As previously announced, we acquired all the outstanding stock of DuBose National Energy Services in Clinton, North Carolina and its affiliate, DuBose National Energy Fasteners & Machined Parts in Cleveland, Ohio on March 1, 2018. As a reminder, the DuBose companies specialize in global fabrication, supply and distribution of metal and metal products to the nuclear industry, including utilities, component manufacturers and contractors. So far, the DuBose acquisitions have been accretive to our earnings and their performance has exceeded our expectations.

Returning capital to our stockholders remains a top priority for Reliance. We increased our regular quarterly cash dividend by 11.1% in the first quarter of 2018, marking the 25th dividend increase since our 1994 IPO. We have paid regular quarterly dividends for 59 consecutive years. While we did not repurchase any shares during the second quarter, we did repurchase $50 million of our common stock in the first quarter of 2018 at an average cost of $84.38 per share. We will continue to be opportunistic in our approach to stock buybacks.

In summary, we are extremely pleased with our second quarter results and the significant earnings milestones our company achieved. This could not have been accomplished without the fantastic performance by our managers in the field, who executed strong pricing discipline, inventory management and expense control. We generated record quarterly sales, record quarterly gross profit dollars, record quarterly pretax income and our second highest quarterly earnings per share.

Looking ahead, despite some continued uncertainty regarding trade actions, we are encouraged by the positive pricing momentum and continuing solid demand conditions. We remain confident in our ability to maximize our earnings power in the current environment with a focus on further increasing value to our stockholders.

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 & Executive VP*

Thanks, Gregg, and good morning, everyone.

Following a record-setting first quarter, I would like to, once again, thank our folks in the field, who contributed to the new records we achieved in the second quarter. Thank you all for the excellent work.

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

Demand for automotive, which we service mainly through our toll processing operations in the U.S. and Mexico continues to be very strong. We continue to grow the volume of metal process for this market mainly as a result of the increased demand for aluminum content into automobiles. We are also continuing to invest in our value-added processing capabilities to support both carbon and aluminum processing to capitalize on this opportunity.

Demand in heavy industry, which includes railcar, truck trailer, shipbuilding, barge manufacturing, tank manufacturers and wind and transmission towers continues to strengthen, specifically spending on both construction and agriculture equipment increased, which, we believe, has been supported by tax reform as our customers respond to heightened demand for their clients, who have increased their capital spending budgets. As a result, we maintained our positive outlook that demand in heavy industry will continue to improve.

Demand in nonresidential construction market, including infrastructure, continues to steadily improve, but it still remains well below peak levels. Similar to heavy industry, we believe tax reform has contributed to the increased activity we are seeing in nonresidential construction. We remain well positioned to support increased volume in our existing footprint and are optimistic that the uptick in activity in the nonresidential construction market will continue.

Demand for the products we sell into the energy market, which is mainly oil and natural gas, continues to recover slowly for the products we sell into this end market. Rig counts and drilling activity continue to grow with mill lead times extending. Completion activity also continues to gain strength. As the overall energy market continues to improve, we remain confident in our ability to service increased demand.

Now, turning to pricing. The metal pricing for carbon steel products was extremely active again during the second quarter of 2018. We were able to take advantage of multiple price increases announced for most of the carbon steel products we sell, by passing on a portion of those increases to our customers before receiving the higher cost metal into inventory. Lead times also remain extended as a result of the strong demand environment and ongoing Section 232 activity.

Looking ahead, we believe pricing for carbon steel products will begin to stabilize in the third quarter of 2018. However, there is some speculation of an additional price increase on carbon flat-rolled and carbon steel plate in the third quarter.

Before I wrap up my remarks, I'd like to also highlight improved pricing trends for alloy products during the second quarter. We believe stronger overall activity in the energy market should continue to support higher alloy pricing going forward.

In summary, demand and pricing remained strong throughout the second quarter. Seasonal factors aside, we expect the underlying demand environment will continue -- will remain solid throughout the remainder of 2018 with prices leveling up. We are very pleased with the strong momentum we experienced during the first half of the year.

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

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

Thank you, Jim. Good morning, everyone.

I would also like to recognize our folks in the field for their phenomenal execution throughout the second quarter. Well done.

I'll now review pricing and demand for our aluminum and stainless steel products, including the key industry trends in the primary markets we sell these products into.

Demand for aerospace remained strong throughout the second quarter. We saw continued strength on both the commercial and defense side with demand primarily supported by single-aisle planes and the increased activity from our defense customers. The backlog for orders remains robust with lead times for aluminum aerospace plate extended beyond what we saw in the first quarter of 2018. Build rates have also continued their upward trajectory since the start of the year. Given the favorable demand environment, our outlook for the aerospace market remains positive. We look forward to continuing to grow our market share in aerospace, given our increased exposure to the defense market and our international expansion activities.

The semiconductor market continued its pattern of rapid growth on a global scale. To capitalize on this growth, we have been working to grow our existing capacity in the U.S., South Korea and China to be better positioned to handle the increased demand. Even if a slight pullback should occur, our outlook on the semiconductor market remains positive for the balance of the year.

Moving on to pricing. The majority of our sales into the aerospace market consists of heat-treated aluminum products, especially plate as well as specialty stainless steel and titanium products. Demand for heat-treated aluminum plate strengthened throughout the second quarter. And while we are encouraged by the positive pricing momentum, we expect prices to level off in the third quarter of 2018. 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 increased during the second quarter, with lead times extending and continuing on allocation. While the Midwest spot price has come down some, the premium remained strong. We expect pricing for these products to increase in the second half based on the recently announced conversion increase of $0.15 per pound. We expect the increase to be supported in the market.

As a reminder, about half of our aluminum sales are to the aerospace market, which is the one area of our business, where we participate in long-term contracts with fixed selling prices. As a result, our aluminum average selling prices generally will not follow market pricing as closely as many of the other products we sell.

Finally, demand for stainless steel flat products, which are primarily sold into the kitchen equipment, appliance and construction end markets, remained robust in the second quarter. Our average selling price for stainless steel products also increased, mainly as a result of the ongoing price increase announcements by the mills related to Section 232 and rising input costs. We saw two 1% discount reductions or price increases since our last conference call, including a recently announced July increase, which has been supported in the market.

Lastly, I'd like to note that pricing for stainless steel products is heavily impacted by nickel prices, which continue to strengthen in the second quarter. And we expect nickel pricing will increase modestly throughout the remainder of the year.

Thank you for your time and attention today. I'll now turn the call over to Karla to review our second quarter 2018 financial results. Karla?

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

Thanks, Bill, and good morning, everyone.

Our net sales in the second quarter of 2018 were a record at $2.99 billion, up 20.8% from the second quarter of 2017 with our tons sold up 2.9% and our average selling price per ton sold up 18.1%.

Compared to the first quarter of 2018, our net sales were up 8.4%, with our tons sold down 0.7% and our average selling price up 9.6%.

We achieved a strong gross profit margin of 30.7% in the second quarter of 2018, exceeding the high end of our estimated range of 27% to 29% and driving record quarterly gross profit dollars of $917.5 million.

On a FIFO basis, our gross profit margin was 32.8%, up 400 basis points from 28.8% in the second quarter of 2017 and up 220 basis points from 30.6% in the first quarter of 2018. As we have explained previously, our gross profit margin may exceed our estimated range in periods of mill price increases as we pass through higher prices to our customers in advance of receiving the higher cost metal into inventory. Because metal prices increased significantly more than we expected in the second quarter, and we now believe prices will remain fairly stable through the third quarter, we have increased our estimated full year LIFO expense to $175 million from our previous estimate of $100 million. As a result, we recorded a LIFO inventory valuation charge or expense of $62.5 million or $0.65 of earnings per diluted share for the second quarter of 2018 compared to $10 million or $0.09 of EPS in the second quarter of 2017 and $25 million or $0.26 of EPS in the first quarter of 2018.

Our LIFO method requires that we record 50% of our annual estimate or $87.5 million of expense in the first half of the year. Given our current annual estimate, we expect to book $43.75 million or $0.46 of earnings per diluted share in both the third and fourth quarters of 2018. And consistent with our practice, we will continue to update our expectations quarterly based on our inventory costs and metal pricing trends.

As a percentage of net sales, our second quarter SG&A expenses were 17.9%, down from 19.2% in the second quarter of 2017 and down from 18.8% in the first quarter of 2018. The reductions as a percentage of sales were primarily due to higher selling prices during the second quarter, which increased our net sales.

Our sales for SG&A expenses were up $14 million or 2.7% from the first quarter of 2018, primarily due to higher incentives resulting from our increased profitability levels and continued increases in freight costs. Pretax income in the second quarter of 2018 was a record $306.6 million, more than double our pretax income of $152.4 million in the second quarter of 2017, and up 36.1% from $225.2 million in the first quarter of 2018. And our pretax income margin in the second quarter of 2018 was 10.3%.

Our effective income tax rate for the second quarter was 24.0%, down from 31.2% in the second quarter of 2017, primarily due to tax reform, contributing positively to our earnings and cash flow. Net income attributable to Reliance for the second quarter of 2018 was $230.8 million or $3.16 earnings per diluted share, the second highest in our company's history. Non-GAAP earnings per diluted share were a record $3.10, up 121.4% from $1.40 in the second quarter of 2017 and up 34.8% from $2.30 in the first quarter of 2018.

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 $83.7 million in cash from operating activities during the second quarter of 2018 despite significantly higher working capital requirements. We invested $56.8 million in capital expenditures and paid $36.1 million in dividends to our stockholders.

At June 30, 2018, our total debt outstanding was $2.05 billion, resulting in a net debt-to-total capital ratio of 27.9%. Our net debt-to-EBITDA multiple was 1.7x.

As of the end of the second quarter, we had $760.8 million available on our $1.5 billion revolving credit facility.

Turning to our outlook, we are optimistic in regard to business conditions in the third quarter of 2018 and anticipate that the end markets in which we operate will continue to gradually improve. However, we anticipate that shipment levels will be impacted by normal seasonal patterns, which include a decline in shipping volumes in the third quarter due to customer shutdowns and vacation schedules. In addition, there's 1 less shipping day in the third quarter of 2018 compared to the second quarter of 2018. As a result, we estimate that our tons sold will be down 2% to 4% in the third quarter of 2018 compared to the second quarter of 2018.

We believe pricing fundamentals will remain steady based on current demand levels and ongoing trade actions. Accordingly, we expect our average selling price per ton sold in the third quarter of 2018 will be up 1% to 3% compared to the second quarter of 2018.

As mentioned previously, if metal pricing remains steady, we anticipate some downward pressure on our gross profit margin as we receive higher cost metal into our inventory. As a result, we currently expect earnings per diluted share to be in the range of $2.65 to $2.75 for the third quarter of 2018.

In closing, we are extremely pleased with our second quarter financial results, which included multiple records and resulted from not only a favorable pricing environment but also from the exceptional execution by our managers in the field. Our strong financial position enables us to continue executing on our capital allocation strategy of investing in the growth of our business and stockholder return activities.

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 comes from the line of Seth Rosenfeld from Jefferies.

Seth R. Rosenfeld - *Jefferies LLC, Research Division - Equity Analyst*

I have 2 questions. Just to better understand your outlook for gross margins, both in the second half of this year and perhaps, longer-term. To start out, I mean, obviously, over recent quarters, you had a number of times strongly outperforming your guidance range of 27%, 29%. Can you talk us through what were the structural elements Reliance is currently enjoying that might allow you to surpass that margin range going forward? When you think about your growth in tolling, in aluminum, a cyclical recovering construction, how much could that add? And then secondly, could you perhaps talk about what impact weakening prices could have on margins? You did talk about the benefit you obviously enjoyed in Q2 from rising prices. With the forward curve pointing to a year-end hot-rolled coil price, $100 below spot, do you think that Reliance could still secure that 27%, 29% margin in that environment? Or is there risk or some downside there?

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

Yes, Seth. So our 27% to 29% gross profit margin range is based on our current -- the way the company is structured today, that is based on our LIFO gross profit margin. So that came in at 30.7% for the quarter. We have said that when we're in periods of rising prices, that we anticipate that we should be at the top end of that range or could exceed it, which is what happened in the second quarter of '18. We had pretty significant price increases during the quarter. So as we have talked about, we typically try to pass those increases on to our customers before we receive the higher cost metal in. So we get that temporary bump in our margin. So that's what occurred in the second quarter. We still think that 27% to 29% range is the right long-term range for us. In weaker markets, whether it's weaker due to demand, pricing, for whatever the reasons are, we would expect to potentially be closer to the low end of that range. From a -- your question from a structural standpoint, how could that range change? Because we did bump it up to the 27% to 29%, I think, at the beginning of '17 from 25% to 27%, which has been our more historical range that we are operating in. And a lot of that, if you recall with -- because we've made a lot of investments in processing equipment, in particular, to do more value-added processing for our customers. So to the extent, as time goes on, if we continue to make investments, which we expect to do, at some point in the future, we could change that 27% to 29% range. But we still think for -- currently, that's the right range for us. It's just the pricing environment -- metal price environment is where we can see some upside to that. And if prices go down, generally, we do see some tightening of the margin in periods where prices are going down. But because we do focus on inventory turnover, we think, we can somewhat minimize the impact on negative impact on our gross profit margin from that.

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

Yes. So if I could -- this is Gregg. If I could comment, in our FIFO gross profit margin of 32.8%, very honestly, it was higher than we anticipated. We expect some pressure on that, given that prices are flattening out in the third quarter, but I don't think it's going to be dramatic. So our guidance of $2.65 to $2.75, we think, is realistic. And when prices, if they start to trend to go down, third quarter basically is already booked, okay. So I don't think if there will be any price decreases that are going to affect anything in the third quarter. We'll see what happens in the fourth quarter. But as they go down, we -- [didn't have] much to say and as we try to pass the increases on before we get it into our inventory when prices are going up. We slow the process down when prices are going down, okay, as best we possibly can. So it minimizes, okay, the impact on our gross profit margins in a declining market. But it does decline. It's just a reality and a fact. So I hope we answered your question.

Seth R. Rosenfeld - *Jefferies LLC, Research Division - Equity Analyst*

Yes. And just one follow-up, you commented earlier about the recoveries you're seeing in the nonresi construction side. I believe, you noted that your existing capacity could support increased volumes without additional costs. Can you just talk us a little bit more what scale of upside that could be achieved in terms of the volume side and what does that mean for fixed cost leverage, please?

James D. Hoffman - *Reliance Steel & Aluminum Co. - COO & Executive VP*

Yes. Seth, this is Jim. We've -- it's just an estimate. We could handle another 20% with the investments we have made over the years in non-residential construction value-added processing. We may have to add a body or 2. But our clients were set up for additional volume and our folks in the field are very good at throughput so we'll be fine with that.

Operator

(Operator Instructions) Our next question comes from the line of Phil Gibbs from KeyBanc.

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

Gregg, how was daily demand in July so far comparing to second quarter average levels? I think you should have a pretty good view right now, given the month is almost over, so just curious on that.

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

Our average daily sales are basically in line with what we saw in the second quarter. So it started off a little slow because of the 4th of July holidays, which is typical. Okay? But as the month progress, our average daily sales progressed with it. So I think that our volumes, our demand in the third quarter are going to be very similar to what we saw in the second quarter, understanding and factoring in the seasonality that does take place with vacations, plant closures, that type of thing so -- and we have, as Karla pointed out, we have 1 less shipping day. We got 63 shipping days as compared to 64 in the second quarter. So that has to be considered as well. But demand in and of itself as compared to the second quarter, I think, is going to be very, very similar.

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

Okay. And Jim, you had mentioned that alloy prices were solid and perhaps getting stronger and you talked a little bit about energy demand as well, you made some comment to that effect. I was wondering what you're alluding to there on those fronts?

James D. Hoffman - *Reliance Steel & Aluminum Co. - COO & Executive VP*

Well, I mean, just from a lead time standpoint, you can see how the lead times are going out in our domestic friends. That's a very difficult product to make. They're extremely busy. The 2 products that, that goes into is automotive and energy, whether it's the lighter, the smaller sizes for auto or the larger sizes for energy. And they're -- all kidding aside, they're struggling to deal with their on-time performance. It's just -- they just get inundated with orders, they're all busy. And especially when you get into the heat-treated type products, there seems to be a little bit of bottleneck there, but we are more than confident that they're capable of improving those things. But as far as the demand is concerned, it's there. And it continues to get better and better, seems to be [weak links]. So you just have to remember the S in SBQ bars means special, so it's really hard to measure.

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

And the last question here is for Bill. I think, Bill, you had mentioned $0.15 increase, I think, on common alloy. Curious about how much of that would have been within the second quarter and how much of that is shifting into the third? And I just was surprised it sounded like a pretty big number. So anything you could provide on that would be helpful.

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

Yes. Phil, it is a big number. The biggest increase I've ever seen in my career on common alloy. So -- but I think it's justified based on where lead times and demand are. It seems to be getting full domestic support. And you're probably going to see that actually -- we'll start to see the results of that late September, end of October. So we're not going to see much of that in Q3.

Operator

Ladies and gentlemen, we have reached the end of the question-and-answer session. And I would like to turn the call back to Gregg for closing remarks.

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

Thank you again for participating in today's call. I'd also like to thank all of our employees, customers, suppliers and stockholders for their continued support and commitment to Reliance Steel. Thanks, again, and have a great day.

Operator

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