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RS - Q3 2013 Reliance Steel & Aluminum Co Earnings Conference Call

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OVERVIEW:

RS reported 3Q13 sales of $2.44b and net income attributable to Co. of $95.1m or $1.22 per diluted share. For 4Q13, expects diluted EPS to be $0.90-1.00.

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Reliance Steel and Aluminum 2013 third-quarter conference call webcast. At this time all participants have been placed in a listen-only mode, and the floor will be open for your questions and comments following the presentation. Now I'd like to turn the floor over to your host, Brenda Miyamoto. Ma'am, the floor is yours.

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

Thank you, Operator. Good morning and thanks to all of you for joining our conference call to discuss our third-quarter financial results. I'm joined by David Hannah, our Chairman and CEO; Gregg Mollins, our President and COO; and Karla Lewis, our Executive Vice President and CFO. Today we're also joined by two of our Senior Vice Presidents of Operations, Jim Hoffman and Bill Sales. A recording of this call will be posted on our website at www.rsac.com in the investor information section.

The press release and the information on this call contains certain forward-looking statements, which are based on a number of assumptions 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 those factors disclosed in the Company's annual report on Form 10-K 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 David Hannah, Chairman and CEO of Reliance.

David Hannah - *Reliance Steel & Aluminum Co - Chairman and CEO*

Good morning, everyone, and thank you for joining us today. The operating environment continues to be challenging. Overall demand in the third quarter was a bit better than we had anticipated, with third quarter tons sold up 2% compared to the prior quarter. Although a significant portion of the increase was due to an additional two weeks of Metals USA activity in the third quarter, our same-store tons sold were up 0.4%. The normal seasonal trend for third-quarter demand is to be down from the second quarter; however our 2013 second-quarter demand was lower than expected.

Metals pricing on the other hand was weaker than we had expected, with our average selling price per ton sold down 2.3% from the prior quarter, and down 9.5% compared to the third quarter last year. Despite this persistently soft pricing environment, which weighs heavily on our net sales and profitability, the strong operational execution by our Managers in the field, partially offset the negative pricing impact as demonstrated by our year-over-year increase in gross profit margin.

Our consistent execution reflects our commitment to remaining highly focused on managing all aspects of the business that are within our control, which continues to mitigate much of the impact from these challenging market conditions. Despite the challenges in the market, we continue to supplement organic growth by profitably expanding through successful M&A activity. Including acquisitions that were completed in 2012 and 2013, third-quarter consolidated net sales were up 18.9%, and tons sold were up 31.3% compared to the same period last year. This solid growth was primarily driven by the acquisition of Metals USA, which was completed early in the second quarter this year and was immediately accretive to our bottom line results.

The integration of Metals USA into the Reliance family continues to progress nicely. The momentum we discussed on our earnings call last quarter and at our Analyst and Investor Day last month continued through the third quarter. While it's difficult to give specific numbers to quantify all of the synergies, anecdotally there are lots of good things happening. We're encouraging open lines of communication and partnering between Metals USA and other Reliance Companies, and we believe this inter-Company cooperation is contributing to more efficiently run operations across our family of service centers.

Since closing the acquisition in April, Metals USA has converted $88.4 million of inventory into cash and improved inventory turns based on dollars to 4.3 times from 3.4 times. Metals USA further improved its gross profit margin to 23.6% in the third quarter, up from 23.3% in the second quarter, and up over 100 basis points from pre-acquisition levels. Clearly, we were very pleased with the Metals USA integration process and our ability to grow Reliance's net sales through M&A activity, even when faced with economic and cyclical headwinds.

Looking ahead, we expect to continue to selectively acquire companies that are well managed, complement our product offerings, grow our presence in targeted end markets, and fit our strategy for profitable growth. We continue to believe that Reliance is the acquirer of choice in our industry and our proven, well-executed acquisition strategy has consistently enhanced the performance of our acquired Companies.

In the third quarter, Reliance's net income was $95.1 million or $1.22 per diluted share. Earnings per share were up from $1.05 in the previous quarter or $1.14 per share on a non-GAAP basis, but down from $1.30 per share in the third quarter of last year. Lower average selling prices in 2013 are the major reason for these lower earnings. In addition, earnings per share declined by $0.08 per diluted share compared to the third quarter last year, due to the differential in our 2013 third-quarter tax rate as well as lower other income.

Sales for the third quarter were $2.44 billion, essentially flat relative to the prior quarter and up 18.9% from the third quarter last year, primarily due to contributions again from the Metals USA acquisition. Pricing was down across all of our product groups from the 2012 third quarter. Although price increases were announced for certain carbon and stainless steel products during the quarter, the pricing environment continues to be challenging. In addition to lower carbon steel pricing, we've experienced significant pressure on stainless and aluminum pricing in 2013 as well as for alloy steel. Our expectation is that overall, we're not likely to see prices strengthen between now and year end. In addition, inventories traditionally tend to decrease during the fourth quarter, as does business activity.

From an end market perspective, the trends we saw in the third quarter were fairly consistent with what we experienced in the prior quarter. Relative demand strength was again led by the auto market through our toll processing operations and was still the only end market where volume increased year over year. Aerospace remains relatively strong, but both pricing and volumes declined in the 2013 third quarter. We expect strong demand from aerospace in 2014 and beyond. Energy, that being oil and gas, was down year over year but demand improved somewhat in the 2013 third quarter from the prior quarter. Our businesses serving the energy markets continued to perform well relative to other end markets and we expect demand to improve next year.

Heavy industry continues to perform reasonably well but we do expect a normal seasonal decline in the 2013 fourth quarter. Non-residential construction continues along its path of a slow and steady recovery with demand still well below peak levels. We're cautiously optimistic that this important end market will continue to make incremental measured progress in 2014.

In July of 2013, our Board of Directors increased our quarterly dividend rate by 10%, and on October 22 of 2013, declared a regular quarterly cash dividend of $0.33 per share of common stock. The Company's paid regular quarterly dividends for 54 consecutive years, and we've increased our dividend 20 times since the IPO. We're pleased that our solid financial position and strong cash flow provides us the flexibility to execute our growth strategies while also returning capital to our shareholders through quarterly cash dividends.

Turning to our outlook for the fourth quarter of 2013. We expect that global economic and political uncertainty, complicated further by political issues here in the US, will continue to present challenges to industrial growth. In addition, fewer shipping days due to the holiday season and extended holiday-related closures at many of our customers' facilities are expected to reduce tons sold in the fourth quarter compared to the 2013 third quarter, which is a typical seasonal trend. We also expect overall pricing to remain near the current low levels for the remainder of the year. As a result for the fourth quarter ending December 31 of 2013, we currently expect earnings per diluted share to be in the range of $0.90 to $1.

As we've noted in the past, Reliance has a broad range of products, significant customer diversification, and a wide geographic footprint. We've achieved industry leading operating results on a consistent basis and we remain confident in our ability to continue our track record of success going forward. I'll now hand the call over to Gregg to comment further on our operations and market conditions, Gregg?

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

Thank you, Dave, and good morning. As Dave pointed out, we are pleased with our results in the third quarter and with the continued progress of the integration of Metals USA into our family of Companies.

FIFO gross profit margins in the second and third quarter were flat at 25.2%. Once again, given the economic environment and all of the uncertainty coming out of Washington, we are proud of our salespeople and Management for their continued focus on managing our margins. Inventory turn in the nine months ending in September on a same-store basis was 4.6 times in tons, consistent with the first half of the year. Our branches continue to work closely with one another by way of sharing and transferring inventory to help maximize our turn.

In spite of some softness in demand, we still feel good about most all the major industries we service and their outlook going forward. Commercial aerospace build rates continue to rise and our Companies doing business in this space are all doing well. Competition on the day-to-day spot business in aerospace has heated up recently and we have seen a slight drop in margin.

Oil and natural gas volumes are holding up well, albeit not at the levels of 2011 and '12. Here again, our Companies doing business in this industry are doing quite well, but there is more pressure on margin due to increased capacity at the producer level. Heavy industries such as rail cars, barge and tank manufacturing, and transmission towers are strong. Agricultural equipment makers in North America are busy and we do quite well in that industry. Obviously, the drag on the heavy industry segment is mining equipment, and unfortunately, that is likely to continue for some time.

Automotive and appliance markets supported by our toll processing businesses in the US and Mexico are doing extremely well, and we continue to deploy capital to support the growth of this group. Non-residential construction continues to show signs of modest improvement, mainly through industrial construction projects throughout North America. Our sense is volume will increase slightly in 2013 compared to 2012, with steady but gradual improvement in 2014 and 2015.

As for pricing on carbon steel products, price increases on flat-rolled products were announced in early June followed by further increases in July, and more recently, in October. In the last four to six weeks, these increases have actually received some positive traction, a combination of numerous outages and production issues in the third and fourth quarter, coupled with low inventories, helped give some momentum to these increases.

Recently, a $30 to $50 a ton increase was announced on plate, soon after EVRAZ announced the closure of their Claymont facility. It seems all the major domestic producers are behind this increase. Beams and mini-mill products have been relatively flat. The concern here has been the large amounts of imports arriving in North America and the spread versus domestic pricing.

As for aluminum, midwest spot ingot is currently trading around $0.90 per pound, down from $1.05 in January. Lead times on aerospace sheet and plate are roughly 8 to 10 weeks, and in some cases as low as 6 weeks. The inventory overhang appears to be spilling into 2014, but it is very difficult to get a real concrete number as to how much inventory is on the floor at the large commercial jet manufactures. This causes mixed signals as to how long the overhang will drag on.

Demand on general engineering and aluminum plate is still good but competitive. Imports remain a problem as the US is a prime destination for plate due to the economic conditions in Europe and elsewhere. Lead times are five to seven weeks. Common alloy sheet demand is still pretty strong and pricing on this product follows ingot.

Stainless steel nickel surcharges have floated in the $0.64 to $0.66 a pound range for the last five months, certainly not where we would like them to be; however, two 2% discounts were removed on base prices, one in August, and the other in October, and both appear to be holding. The good news is demand in stainless flat-rolled and bar is still quite strong and we're very happy with that.

To conclude, we are still very excited about the recent acquisition of Metals USA and how they are integrating with our existing Companies. We continue to share best practices with one another and are happy to say it is going better than we expected. We believe the major industries that we support will continue to improve and we will make every effort to grow our business with them.

We have tremendous respect for our Management teams in the field and their ability to provide industry leading results in both profitability and working capital management. We fully expect to see the typical seasonality trend in the fourth quarter, which we experience almost every year due to the holidays. Now I will turn the program over to Karla to review the financials. Karla?

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

Thanks, Gregg and good morning everyone. As discussed, our increased tons sold are being offset by the weak pricing environment. Our average price per ton sold in the third quarter of $1,679 was 2.3% lower on a sequential quarter basis and 9.5% lower year over year, reflecting recent trends in metal pricing as well as shifts in our product mix, mainly from our acquisition of Metals USA.

On a same-store basis, which excludes the sales of our 2012 and 2013 acquisitions, sales were $1.96 billion, down 3.2% compared to the third quarter last year, with a 3.1% increase in tons sold and a 6.3% decrease in our average selling price. Same-store sales compared to last quarter were down 1.8% with a 0.4% increase in tons sold and a 2.3% decrease in our average selling price.

Our gross profit margins have held up very well at 26.3% for the 2013 third quarter, up from 26.0% in the third quarter of last year and 25.4% in the prior quarter. Our local Managers have been able to maintain FIFO gross profit margins at good levels despite the difficult pricing environment. Given the declining price environment in 2013, our LIFO adjustment is contributing positively to our gross profit margin and earnings, as it is intended to do by reflecting our cost of sales at current replacement cost. Our LIFO adjustment for the quarter was a credit or income of $27.5 million or $0.22 per share, compared to income of $27 million, also $0.22 per share in the third quarter of last year, an income of $5 million or $0.04 per share in the prior quarter.

Given that prices dipped lower than we had anticipated earlier this year, along with our current expectations that pricing will likely remain under pressure through the end of 2013, we have increased our annual LIFO adjustment estimate from a $20 million credit to a $50 million credit. As of September 30, 2013, our actual LIFO calculation resulted in LIFO income of $44.7 million. Our updated annual estimate of $50 million indicates a fourth-quarter LIFO credit of $12.5 million; however, please remember that LIFO is an annual adjustment so we will book to our actual calculation as of December 31, based on actual quantities and costs on hand at that date and then begin again in 2014. Both our FIFO and LIFO gross profit margins have remained in our historical range of 25% to 27% in 2013 despite the weak pricing environment and shift in product mix due to the Metals USA acquisition.

As a percentage of sales our SG&A expenses for the third quarter were 17.6%, compared to 16.8% for the third quarter last year, due mainly to the impact of significantly lower metal prices on net sales in 2013 compared to 2012. Our current cost structure can support significantly higher volume and we anticipate that our SG&A expense as a percentage of sales will begin to fall as our volumes improve and as prices increase. For illustration purposes only, if we were to apply our average selling price per tons sold in the 2012 third quarter of $1,856 to our 2013 third-quarter tons sold of 1.45 million tons, sales would be approximately $2.69 billion with SG&A expenses of $430 million, representing 16.0% of sales. We recognize this is not a perfect comparison as our expenses would increase somewhat due to higher commission and incentive payments, but believe this demonstrates the impact of pricing.

Similar to the second quarter, our 2013 third quarter includes significantly higher amortization and interest expense compared to prior quarters, mainly due to the acquisition of Metals USA, including our costs to finance the transaction. Our earnings per share was $0.08 lower in the 2013 third quarter as compared to a year ago due to non-operational items. This includes a decrease in other income of $4.7 million or about $0.03 per share, mainly because of fluctuations in foreign currency as well as a $2.5 million gain on a real estate sale in the 2012 third quarter. In addition, our effective income tax rate for the third quarter was 32.7%, compared to a rate of 30.9% in the 2012 third quarter, also decreasing current earnings per share by $0.04.

Third-quarter net income attributable to Reliance was $95.1 million or $1.22 per diluted share. We did not incur any one-time expenses in the 2013 third quarter. During the prior quarter, we had non-GAAP earnings per diluted share of $1.14, adjusted for one-time expenses of $10.3 million related to the Metals USA acquisition as well as the consolidation of an existing facility. Our third-quarter results include contributions from Metals USA for the full quarter with sales of $432.3 million, compared to $396.5 million in the second quarter. FIFO pre-tax income of $15.2 million was up from $14 million, and FIFO earnings per share of $0.13 per diluted share, compared to $0.12 in the prior quarter, which include interest expense on our borrowings to fund the $1.25 billion acquisition price.

As we indicated on prior calls it will take some time for Reliance to realize the full synergies associated with the transaction. Metals USA realized direct synergies of about $4.4 million in the third quarter, compared to $2.3 million in the prior quarter. The 2013 third quarter includes some initial improvement in metal purchasing and we expect these benefits to increase in the future. We continue to expect to realize at least $15 million to $20 million in synergies per year.

We remain very pleased with the integration of Metals USA, which was accretive to both our second- and third-quarter earnings. We generated cash from operations of $229.1 million for the quarter due to a continued focus on effective working capital management. Our accounts receivable day sales outstanding rate as of September 30 was consistent with the prior year at about 41.3 days. Our inventory turn rate based on dollars was 4.2 times, consistent with the prior quarter and a slight improvement from our 2012 rate of 4.0 times, and our goal continues to be 4.75 turns on a Company-wide level.

We invested $44.5 million for capital expenditures during the third quarter and $118.7 million year to date. Our 2013 capital expenditure budget remains approximately $220 million, including Metals USA. During the quarter, we used our excess cash to pay down debt of $183.1 million, reducing outstanding borrowings on our $1.5 billion credit facility to $500 million. Our total outstanding debt at September 30 was $2.15 billion, and our net debt to total capital ratio was 34.9%, down from 39.4% upon funding our $1.25 billion acquisition of Metals USA in April.

We remain comfortable with our leverage and liquidity position, but do plan to continue to use cash from operations to reduce current debt levels as well as support our working capital needs, maintain our quarterly dividend, and fund growth both through organic means, mainly through capital expenditures, and through acquisitions, when appropriate. That concludes our prepared remarks. Thank you for your attention. And at this time, I'd like to open the call up to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

We'll take our first question from Sal Tharani with Goldman Sachs. Your line is live.

Sal Tharani - *Goldman Sachs - Analyst*

Thank you very much. Gregg, I just want to understand the pricing pressure you mentioned in the aerospace side. Is that on across-the-board on titanium and aluminum plate and everything or is it just on the aluminum plate?

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

I was focusing more on the aluminum place issue, Sal, and I really didn't think about the titanium that much. It's such a small part of our business, overall it's less than 1%, so my comments were focused around the aluminum plate aerospace business.

Sal Tharani - *Goldman Sachs - Analyst*

And you mentioned that difficult to gauge what inventory level is at the large OEMs. How do you see the inventories at the suppliers at the mills?

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

I think their inventories are probably growing a little bit with their lead times going down, Bill can probably comment more on that. But I think the difference between ourselves and the mills' perspective is that because the OEMs have inventory on their floor, their direct shipments from the mill to the commercial aircraft builders are less, as opposed to in the distribution in our business, okay, our contract business is running steady, it is, so there's no really big deal there. We are having some pressure on the spot market as I mentioned in my remarks on the margin side, but really the biggest difference between ourselves and the mills is that the mills are receiving less mill direct business, would you say that Bill?

Bill Sales - *Reliance Steel & Aluminum Co - SVP of Operations*

Yes, absolutely. Sal, the plate overhang its been kind of difficult. It's been a moving target for us to get our arms around exactly when we will see that burn off. We started the year thinking that it probably would be burned off by the end of this year, as we got closer to the end of the year we move that into mid 2014. We're now hearing some reports that maybe it's going to even reach out into 2015, and it's really tied to inventory levels at the big two OEMs and it's probably more significant with one versus the other, and as Gregg said that has more of an impact on the mills, on the mill direct business.

It's probably going to have more impact in Europe than it's going to have in the US, and you're looking at our business, the demand has been good. We are seeing the pressure on pricing, and looking out into next year we think demand will continue to be good but we'll also see continued pressure on pricing.

Sal Tharani - *Goldman Sachs - Analyst*

Okay, and one more on the SBQ, Gregg what are we seeing on the SBQ front?

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

Well we're seeing -- why don't I let Jim comment, Jim?

Jim Hoffman - *Reliance Steel & Aluminum Co - SVP of Operations*

Yes, Sal, what we're seeing, it continues to be a good market for us. There's demand out there. The biggest hurdle we have is what I would call overcapacity at the production level, the vast majority of the SBQ bar producers all added capacity at the same time; however, like I said earlier, the demand is there. Demand is very good for us, but we may see some pressure on margins due to the fact that there's so much capacity out there.

Sal Tharani - *Goldman Sachs - Analyst*

Great, thank you very much.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

Thanks, Sal.

Operator

Okay. We'll take our next question from Chris Olin with Cleveland Research.

Chris Olin - *Cleveland Research Company - Analyst*

Thanks for taking my call.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

Hi Chris.

Chris Olin - *Cleveland Research Company - Analyst*

Just wanted to focus a little bit more on your non-residential construction outlook. We've been seeing some positive trends and some backlogs building and it seems to be driven by these increased demand outlook for chemical processing, energy infrastructure in the Gulf states, you've got some investments directed at port capacity, and then TIFIA related highway spending. And I guess do you expect these markets to start contributing to your portfolio or could that be a positive upside driver? Do you have leverage to these markets? Any thoughts would be interesting.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

Well, those markets we do expect as you just mentioned them to provide us with additional business going forward. As of today, we've seen some of that, the industrial market in that segment has been doing fairly well with us, but the pure generic non-res has just been increasing moderately throughout the year and we expect that to continue in '14 and '15.

But those projects that you mentioned, they are definitely on our radar screen. We have companies that surround all those areas in particular in the Gulf Coast, and we're ready, willing, and able to take care of the needs of all those projects. So yes, we feel positive about those, but to say that we've experienced a great deal of growth in those markets today would be, we would be misleading you if we said that was taking place.

Chris Olin - *Cleveland Research Company - Analyst*

What is the current non-res mix in terms of revenues, and of that do you know how much would be considered public or highway related?

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

No. We don't break it down in that detail.

David Hannah - *Reliance Steel & Aluminum Co - Chairman and CEO*

I think non-residential we used to tell you that non-res was about one-third of our business, and since it's dropped and we've seen some improvement in other ends of the business, it's probably just below 30% now, maybe in the high 20%s. But we also include infrastructure in that, so it's not just pure construction of commercial and industrial buildings, and we don't have a read as Gregg just mentioned on the public versus private end of it.

What we do know is that in the prior few years we had a little bit more public participation and that seems to have dried up and we are experiencing as Gregg also mentioned the improvement in the industrial side. It's just been spotty. It hasn't been real consistent. I think in the Gulf area it's been pretty good and in the Northeast, the East Coast have been the best areas if you want to call it that for non-res for us.

Chris Olin - *Cleveland Research Company - Analyst*

Okay, thanks a lot.

Operator

Okay, we'll take our next question from Timna Tanners with Bank of America Merrill Lynch. Your line is live.

Timna Tanners - *BofA Merrill Lynch - Analyst*

Yes, hi good morning everyone.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

Hello, Timna.

Timna Tanners - *BofA Merrill Lynch - Analyst*

So wanted to ask for starters on your observations in the import market, kind of taking advantage of you here because we can't get any information from the government site yet. They're still not back to work I guess, so just wanted your thoughts on imports there, how they are affecting your business and what you might see in the near term ahead?

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

Well it depends on the product mix but we access the same data that you do and there's no data to be accessed, so I wish I could comment on that but I really can't. We think that the imports, there was a huge surge in imports in the first half of the year. It began to go down somewhat in the third quarter and we think that that will probably continue into the fourth quarter. So it's not going to be as dramatic as far as imports coming into the United States in the fourth quarter as it was in the first half of the year in our opinion.

David Hannah - *Reliance Steel & Aluminum Co - Chairman and CEO*

And you're referring to certain products?

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

More along the line of flat-roll, plate, and structural beams.

Timna Tanners - *BofA Merrill Lynch - Analyst*

Okay. And I guess on the LIFO side it was a big increase quarter over quarter, so anymore color there, obviously I know Karla touched on that. And similarly on the last call you had said that you were looking still to right size inventory and it didn't look like it came down that much, so should we assume that's a goal that's going to continue to be a focus in the fourth quarter or beyond?

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

Hi, Timna. So as far as the LIFO goes, I think we've explained to you guys previously we do our calculations every month and then base our annual estimate on that along with what our outlook is for the rest of the year, and earlier in the year, we felt we would see a little more pick up in prices coming into the third quarter. The last time we talked to you guys on an earnings call there had been some price increase announcements, mainly for carbon, so just remember we've also got quite a bit in stainless and aluminum that also impacts our overall LIFO. So I think prices that the actual cost we received in during the third quarter brought us down.

If you look at our actual LIFO calculations from June 30 to September 30, they went up $25.3 million because of the lower cost of our inventory, so that really led to the increase in the estimates, so we're kind of sitting on what we think the LIFO will be. Again a lot of it is just due to the price as we continue to receive in lower cost metal.

And on the inventory turns, you're right. We stayed pretty consistent with where we were. I think all of our operations continued to work towards that, towards our goal of the 4.75 turn on a dollar basis. And during the fourth quarter we typically do reduce our inventory levels, so certainly we would expect to see total inventory levels come down, business activity also falls off during the fourth quarter too, but hopefully we'll make some progress on the inventory turns.

Timna Tanners - *BofA Merrill Lynch - Analyst*

Okay, helpful. If I could get one last one in. I just wanted more color on Gregg's comments on the pressure on the spot market. I thought that was interesting. We've been hearing from other service centers all year on the carbon side there's been a lot of difficulty in passing through higher prices to customers, but Reliance has always had a little better traction it seems like, so just wondering if this is a change in Reliance or is this something, if you could help explain why this might have occurred for you guys in this last quarter more.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

Actually, I was referring more to the aerospace plate market, the spot prices there were a little bit more challenging than they have in the past, and that represents like 4% of our business and the pressure on the margin is very minimal. But as far as the pressure on the carbon steel plate side, there's always pressure on the carbon steel plate side, that's all I've got to say.

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

I think Timna, you have to remember too we're a little different than a lot of the other larger service centers with our focus on small order sizes and quick deliveries, so with the level of service we provide we think that helps us keep our margin.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

Yes, and Timna, just for the record, our model has not changed, our model will never change, okay, we're just one of those guys that just move along day to day and take small orders and we try to maximize our profits on each and every invoice.

Timna Tanners - *BofA Merrill Lynch - Analyst*

Got you. Thanks again.

Operator

Thank you very much. We'll take our next question from Luke Folta with Jefferies.

Luke Folta - *Jefferies & Company - Analyst*

Good morning.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

Good morning.

Luke Folta - *Jefferies & Company - Analyst*

First question on the aerospace heat treat plate side of your business, you talk about demand improving but the mills continuing to de-stock. I guess when it comes to your specific business do you expect your volumes to be higher or lower in 2014?

Bill Sales - *Reliance Steel & Aluminum Co - SVP of Operations*

Luke, this is Bill Sales. I think we expect our demand to be relatively equal to what it was this year. We think demand for next year is still going to stay good. There's a tone out there that this is really turning into a bad market or a tough market and our view as we look, it's been a great market. We think it will be a good market going forward into 2014.

David Hannah - *Reliance Steel & Aluminum Co - Chairman and CEO*

We still expect it, Luke, to be one of our top performing parts of our business next year where the Companies in that part of the business and the industry will continue to have among if not the top returns in our Company probably it's either energy, oil and gas, or it's the aerospace side that's going to produce our top returns. That's true for this year and we expect it to be true for next year also.

Luke Folta - *Jefferies & Company - Analyst*

Okay, and just in your commentary you talked about some increase in competition in that market. I was just curious to understand is that more like mill direct business or is that other distributors just intensifying their participation?

David Hannah - *Reliance Steel & Aluminum Co - Chairman and CEO*

Well, you know, what I think what we were trying to convey is that we've heard some commentary from some of the major producers over the last week or so indicating that there's pressure on pricing and demand and what not, and we were trying to differentiate and show you a difference between ourselves and the mills because the producers sell a lot of the material direct to the commercial aircraft builders and that business is going to be slower for them because of the build up and the overhang that we've discussed.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

So basically they've already sold that material to the producers.

David Hannah - *Reliance Steel & Aluminum Co - Chairman and CEO*

Correct.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

The OEMs. And it's still sitting there because their build rates haven't been at the levels that they had anticipated.

David Hannah - *Reliance Steel & Aluminum Co - Chairman and CEO*

Correct. But for us, we don't have that direct, and our contractual business that we have in that space is still moving along well. We haven't seen any slowdown in activity in that area. On the spot market, because of availability and what not and other people who have take or pay agreements, then their business, they want to move inventory, so it's a normal cycle for them to be a little bit more competitive at times.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

There's really no change in terms of who we're competing with. It's just more competitive out there and that's put pressure on pricing.

Luke Folta - *Jefferies & Company - Analyst*

Okay, and then just one last one. On SBQ, is your participation in that business pretty much 100% spot or do you do some contract stuff there?

Jim Hoffman - *Reliance Steel & Aluminum Co - SVP of Operations*

This is Jim Hoffman, Luke. Very little contract. Mostly transactional business.

Luke Folta - *Jefferies & Company - Analyst*

Okay, thank you very much.

Operator

We'll take our next question from Tony Rizzuto with Cowen and Company. Your line is live.

Tony Rizzuto - *Cowen Securities LLC - Analyst*

Thanks very much and hi everyone. I've got several questions. Maybe first just to follow-up on the carbon flat-rolled sheet area a little bit, I wonder if you think there's scope for further increases and could this be exacerbated by the pretty lean inventory in the supply chain?

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

That lean inventory would definitely support a potential other increase. I don't know, Tony if there's going to be one, it would not surprise me that there would be. We're frankly anticipating that the mills might throw out another increase prior to the end of the year. It certainly helps their position with the service center inventories being as low as they are.

David Hannah - *Reliance Steel & Aluminum Co - Chairman and CEO*

I think Tony too, the inventories, they are low compared to historical levels but they are probably about right compared to what demand is. So if there's an increase, in order for Reliance to want to buy more inventory, we're going to have to be convinced that our demand is going up.

And I don't think -- we hear a lot about stocking and de-stocking and restocking and that's not something that we really embrace here. We'll buy more inventory when our order book gets more full. And so I think the thing, the one thing that can improve pricing if you're really across any product you want to talk about, but we're talking about carbon flat-roll, is really an improvement in demand. In order to get sustained price increases that will stick, we need better demand.

Tony Rizzuto - *Cowen Securities LLC - Analyst*

Fair enough. And I wanted to follow-up on Metals USA a little bit too, and it seems like you guys are generally on target with your goals as far as inventory turns and overall margins. But as you had a chance to take a closer look and dig into the locations, are you finding any opportunities out there for consolidation or maybe where margin opportunities not where they should be or where you think they can get, and could there be some opportunities from that standpoint?

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

We're taking a look at that closely as far as on the merger side. At this point in time, we see some opportunities but we really can't comment on that at this point, Tony.

Tony Rizzuto - *Cowen Securities LLC - Analyst*

Okay, no problem. Just to follow-up on the [allie] heat treat plate market and I just want to confirm, I think I heard Bill say that with regard to 2014 volumes that for you guys they are likely to remain flattish? Did I hear that correctly? I just wanted to confirm that.

Bill Sales - *Reliance Steel & Aluminum Co - SVP of Operations*

We look at 2014 and think the volume is going to be flat to slightly up.

Tony Rizzuto - *Cowen Securities LLC - Analyst*

Flat to slightly up. And Bill would that include both 60-61 and the 2- and 7-series as well?

Bill Sales - *Reliance Steel & Aluminum Co - SVP of Operations*

It really does, Tony. The comment was really directed more toward aerospace but I think that would also be true on the 60-61 side. Maybe a little more of an increase on the 61 side. It typically tracks with the overall economy if you expect the overall economy to improve a little bit. Our 61 plate level should improve with that.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

The one area too Bill, I think that we're expecting some improvement next year over this year which includes 61 plate is on the electronics and the semiconductor side.

Tony Rizzuto - *Cowen Securities LLC - Analyst*

Would you guys overall, is it possible that you could break out your percentage or rough ballpark of how you're split between general engineering and aero-heat treat? Is that possible?

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

I think we do have the heat treat broken out within our product mix Tony. Our sell-side product category. We don't break 60-61 out.

David Hannah - *Reliance Steel & Aluminum Co - Chairman and CEO*

The heat treat plate component of our aluminum is a little less than 25% of our aluminum sales, so on a dollar basis. So if aluminum is 15%, 16% of our total revenue dollars, the heat treat plate component of that is about 25% of that, a little less than 25% of that, but that does include the 61.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

It does.

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

It's like 3% of total revenue dollars.

Tony Rizzuto - *Cowen Securities LLC - Analyst*

Okay, that's great. Thank you very much everyone.

Gregg Mollins - *Reliance Steel & Aluminum Co - President and COO*

Thanks, Tony.

Operator

We'll take our next question from Phil Gibbs with KeyBanc Capital Markets.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Good morning. Just had a question on your priority for capital deployment going forward and what your appetite may be given your current balance sheet and liquidity for larger deals.

David Hannah - *Reliance Steel & Aluminum Co - Chairman and CEO*

We still have an appetite for larger deals. We have an appetite for smaller deals as well, but we like to do the larger ones when they're available, but our industry is made up mostly of a large number of smaller companies. So that's been the case for the last 20 years or plus, and that will probably be the case going forward, so we have an appetite for both of those.

In terms of capital deployment, certainly right now, we're looking to pay down debt. After paying down debt, certainly maintaining our dividend, also growth both this is where we get into the M&A side. But also we spend a fair amount of money on capital expenditures to support organic growth and that's important to us. When we look at acquisition opportunities, we're looking for companies out there that we think we can take from where they are today and help them get to be bigger and better than they are at the time that we acquire them. And a lot of the time, that just means that we need to spend some money on CapEx, so certainly that's an important part of it too.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Karla, did you comment on what you expected the CapEx to be for the year? I may have missed that.

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

So we gave our current 2013 CapEx budget of $120 million. We're just under $120 million spent for the first nine months. We're in the process right now of developing our budget for 2014. It will probably be pretty similar but we don't have that number yet.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Okay, and I appreciate that. I just had one more question on the oil and gas market. I know that you've done some growth with your customers in oil and gas and you may have mentioned something on a couple past calls about moving into Southeast Asia. Just curious as to what you may be seeing as far as demand going forward in the US versus maybe offshore demand.

Jim Hoffman - *Reliance Steel & Aluminum Co - SVP of Operations*

We continue to see as a nice space to be in, the industry has legs, we've made a couple acquisitions here over the last couple years. They've all worked out. As far as expanding into Southeast Asia, as Dave has said in the past we basically follow customers. When customers want us to be there we have a tendency to get there, but right now, we kind of like where we are right now and we like the diversification of the Companies we own and the market itself.

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

We do have a few locations in Malaysia, servicing that industry and Singapore, but they're fairly small for us as a total Company, as Jim said we're there to support the customers and we'll continue to do that. But I think our outlook for continued growth is more US focused, US and Canada than over in Asia just because of the relative size to the Company.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Okay, thanks very much.

Operator

Thank you very much, ladies and gentlemen. The floor remains open for questions.

(Operator Instructions)

We'll take our next question from Matthew Murphy with UBS. Your line is live.

Matthew Murphy - *UBS - Analyst*

I had a question on SG&A, up around 1% quarter over quarter, and I guess are the MUSA synergies being recognized mostly in SG&A? And what's the thinking on levels in 2014 if we assume volumes and pricing are flat?

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

From a quarter-to-quarter basis we do have two weeks more of Metals USA activity including SG&A expenses in the third quarter, so on a same-store basis, we're actually down a little bit, so that makes up most of the increase from a dollar perspective.

From a synergy standpoint, the $4.4 million of synergies we reported for this quarter, that's about half and half between SG&A expense and cost of sales. I think we would expect SG&A to continue at that rate going forward, absent any changes as Gregg had mentioned whether or not we do any types of consolidations or things. But we would expect more of the potential upside on synergies there to be on the metal purchasing side from where we are today.

As far as going into 2014, you know our SG&A rates have been in the 17% as a percent of sales. If pricing and volumes stay where they are today, we're probably going to stay in that 16% to 17% of sales range, but as we've tried to point out before, we have not after the downturn in '09, we didn't go out and shutdown locations, so we have quite a bit of capacity out there when we get the volume back. And also as prices improve, we have commented we think in a more normal environment our SG&A expense as a percent of sales should be closer to that 14.5% of sales, so there's a lot of upside there, when demand and pricing come back it should fall to the earnings line.

Matthew Murphy - *UBS - Analyst*

Got you, thanks.

Operator

Okay, it looks like we have one final follow-up coming from Phil Gibbs with KeyBanc. Your line is live.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Yes, I was just more or less curious on how your Company is taking on the Affordable Care Act and what impacts that may have on you guys as to how you're managing the business or how you're thinking about things moving forward related to healthcare and how that's impacting you and how you're thinking about it.

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

Yes, Phil, so one of the things we had done at Reliance fairly recently which was more from a business perspective, was we instead of having individual plans, healthcare plans at our different Companies, we did roll that all up towards the end of 2011. So we have a Company-wide healthcare program in place now which brought some savings to the Company by taking advantage of our size. And we think we're providing very good benefits to our employees with some savings by doing that. Of course healthcare costs are high and continue to increase, and we have the government regulations now that we've got to work towards.

But our plans are compliant. We think we have a good package for our employees but we are going to, we continue to evaluate that and phase in the Affordable Care Act as we move forward. Probably we'll be forced to change a little bit in the style or level of benefits because of those government requirements, but we're still analyzing all that and currently, there hasn't been a significant impact on us.

Phil Gibbs - *KeyBanc Capital Markets - Analyst*

Thank you.

Operator

Okay, I'm showing no further questions in queue. I'd like to turn the floor back to Mr. Hannah for any closing comments you'd like to make.

David Hannah - *Reliance Steel & Aluminum Co - Chairman and CEO*

Sure. Thanks again for your time and your support and I'd like to close by saying, business is okay. It's not as bad as a lot of people think it is out there. There's volume, the headwinds this year as we've all alluded to have been really in the pricing area. So when we look forward into next year, we do expect incremental increases in demand, probably mid- to high-single digits in terms of volume improvement next year, and we certainly expect pricing in all of our product groups to be better than it is now, because it's all pretty low at this point and we just can't see it going any lower very honestly.

So we're optimistic about next year in a measured kind of way and we feel good about our position in the industry and where we're headed. So with that I'd like again to thank you for your support and for your participation in the call today. And we do want to remind everyone that we'll be presenting at the Cowen Global Metals Mining and Materials Conference on November 13t, and also the Goldman Sachs, Global Metals and Mining Conference on November 20, both of which will be held in New York and we hope to see some of you or all of you there. And thank you again, have a great day.

Operator

Thank you very much, ladies and gentlemen. This concludes today's presentation. You may disconnect your lines and have a wonderful day. Thank you for your participation.