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Conference Call Transcript

RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

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PRESENTATION

Operator

Good morning ladies and gentlemen, and welcome to the Reliance Steel & Aluminum Co. third-quarter conference call. At this time all participants have been placed on a listen-only mode. We will open the floor for your questions and comments after the presentation. It is now my pleasure to turn the floor over to your host, David Hannah. Sir, the floor is yours.

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

Good morning and thank you for taking the time to listen to our conference call for the third quarter and nine months ended September 30, 2009. Gregg Mollins, our President and Chief Operating Officer, and Karla Lewis, our Executive Vice President and Chief Financial Officer are also here with me today. After the completion of this conference call a printed transcript including Regulation G Reconciliations will be posted on our website at: www.rsac.com.com, in the Investor Information section.

Oct. 22, 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

For the nine months ended September 30, 2009, net income amounted to \$56.1 million, compared with net income of \$416.5 million for the same period in 2008. Earnings per diluted share were \$.76 for the nine months ended September 30, 2009, compared with earnings of \$5.65 per diluted share for the nine months ended September 30, 2008. Sales for the 2009 year-to-date period were \$4.04 billion, compared with 2008 nine month sales of \$6.58 billion.

For the 2009 third quarter, Reliance reported net income of \$41.8 million, or \$.57 per diluted share, compared to a loss of \$5.8 million, or \$.08 per diluted share, for the 2009 second quarter and compared to net income of \$152.5 million, or \$2.07 per diluted share for the 2008 third quarter. Sales for the 2009 third quarter were \$1.24 billion, unchanged from the 2009 second quarter and down 52% from the 2008 third quarter sales of \$2.57 billion.

Our 2009 third quarter results improved significantly from the 2009 first and second quarters. Overall, compared to the second quarter, our average daily sales were flat, with tons sold and average prices per ton sold essentially unchanged. We did see, however, a change in the downward trends that have occurred each month during the first seven months of the year. Our August and September average daily sales increased 7% and 5%, respectively, compared to the prior month. These increases were supported by increases in tons shipped per day of 5% and 4%, again compared to the prior month. While we do not believe that these improvements are evidence of any meaningful recovery in real demand, they do add support to the argument that customers are buying again, not restocking, but at least buying to support the existing low levels of demand for their products.

In addition to the slightly better market for our products, we were able to increase prices to our customers as mill pricing strengthened, again mostly in August and September. This, combined with our inventory costs being more in line with current replacement costs, resulted in an increase in our 2009 third quarter gross profit margins of about 6 percentage points over the prior quarter. This increase in gross profit margins was responsible for the improvement in our 2009 third quarter operating results.

In total, we sold about 866,000 tons of metal during the 2009 third quarter, compared to 873,000 tons for the second quarter. By major product group, we sold 727,000 tons of carbon steel products during the 2009 third quarter, which was down 1.8% from the prior quarter, with average selling prices down 2.8%. Aluminum sales were 47,000 tons, up 1.2% from the second quarter, with average prices down 1.8%. Stainless steel sales were about 42,000 tons, up 5.5% from the prior quarter with average prices up 6.6%. Alloy sales were 33,000 tons, up 5.5% with prices down 2.5%.

Our aerospace businesses continue to be the top performers, and we saw some increased activity in the energy and oil & gas sector after it slowed a bit in the second quarter. We have also seen some improvement in the electronics and semiconductor areas that we believe will continue into next year. As you already know, business levels relative to private commercial and industrial construction are the most challenging and we do not see any improvement in the near term. We will remain hopeful that some infrastructure work will begin to appear, as we have seen some increased quoting activity in that area.

Starting in the fourth quarter of 2008 we focused our efforts on maintaining profitability, maximizing cash flow through working capital management, paying down debt and reducing expenses. We are satisfied that we have accomplished what we set out to do. During the first nine months of 2009 we generated record cash flow from operations of \$807 million, due in part to our profitability, but mostly from our reduction in working capital. We have paid down over \$1.2 billion of debt since September 2008, leaving our net debt-to-total capital ratio at only 28% as of September 30, 2009. On a same-store basis, our operating expenses for the 2009 nine months are down \$209 million, or 24%, compared to the 2008 nine month period.

Our inventory position has continued to improve as we reduced our FIFO inventory by \$92 million during the quarter. We still expect further reductions through the end of the year. Our tons on hand at September 30, 2009 represented 2.5 months based on September's shipments. Looking forward, we expect shipments in the fourth quarter to be less than in the third quarter, due mainly to normal seasonal conditions. Pricing, in general, is expected to be flat to down slightly compared to the third quarter. Gross profit margins may also contract some as we do not expect support from additional mill price increases like we had in the third quarter.

Because of the uncertainty surrounding business conditions later in the 2009 fourth quarter, we are not comfortable providing fourth quarter earnings guidance at this time. We will, as the quarter progresses, communicate any meaningful information with regard to our operations as it becomes available.

On October 21, 2009, the Board of Directors declared a regular quarterly cash dividend of \$.10 per share of common stock. The dividend is payable on January 6, 2010 to shareholders of record December 4, 2009. The Company has paid regular quarterly dividends for 49 consecutive years.

Oct. 22, 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

In closing, we are still in challenging economic times, but we seem to have bottomed out as business conditions have improved somewhat from the low points in July. Our management teams have done a remarkable job positioning the Company for the eventual recovery and we stand on solid footings ready to take advantage of any attractive business opportunities. Thank you. I will now turn the call over to Gregg for some additional comments on our operations and market conditions.

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

Thank you Dave and Good Morning. We are pleased with our results in the third quarter as compared to what took place in the second quarter. Average daily sales and volume hit bottom in July and slowly began to inch its way up in the August – September time frame. It is way too early to call this a trend, especially heading into the fourth quarter, but as they say “pray for the best and prepare for the worst” – and that is what we intend to do.

We continued to encourage our business units to reduce their inventories and once again they responded by taking out \$92 million worth of inventory during the 2009 third quarter. Since the first of the year, we have reduced our inventory by over \$700 million dollars creating outstanding cash flow. Managing gross profit margins has been our greatest challenge this year. Massive de-stocking and liquidation of inventory during the first-half resulted in major pressure on our selling prices and our gross profit margins. Fortunately the producers of most all the products we sell, implemented price increases beginning in June of 2009, which we were able to pass along to our customers prior to receiving the higher cost material.

This contributed to 6.5% rise in our FIFO gross profit margins in the third quarter. Compared to the second quarter, we increased our FIFO margins to 23.2% from 16.7%. This was huge and we give all the credit to our managers and their teams for their courage to risk volume for profit after coming out of a prolonged period of liquidating inventory in our industry. What were the bright spots in the quarter? Obviously pricing was number one but there were a few industries that performed better than others. We saw improvements in bridge building, barge manufacturing, tank builders and infrastructure rebuild. We continue to do well in aerospace, in particular, military and defense. Electronics and semiconductor equipment manufacturers build rates are improving as we speak. Non-residential construction continues to lag and we do not expect this to change anytime soon.

As for pricing, we believe carbon steel will have its challenges in the 2009 fourth quarter due to lackluster demand, seasonality issues, an increase in plant closures during the Holidays and the real number of actual shipping days in the quarter. Producers matching production to demand will be of vital importance to maintaining reasonable pricing levels. Any significant price reductions will only drive profits down and not gain one extra ton of steel. Pricing following the ebb and flow of scrap would be beneficial for all. We shall see. Hopefully exporting will be even more attractive for our domestic producers in the coming months. Unlike some others, we believe our domestic producers do exert pricing discipline, given the hand they are dealt, and there will not be any “pay back” from Reliance.

We believe aluminum ingot is in a comfortable range in the mid \$.80 to \$.90 a pound range on the Midwest spot market. This range allows producers and service centers to make reasonable profits and is low enough to help stimulate demand. Common alloy aluminum coil remains in tight supply, primarily due to the idling of some capacity at the mill level. This has resulted in several conversion price increases that have held in the market. Heat treat plate supporting the aerospace markets is readily available and demand is expected to remain soft for the foreseeable future.

Stainless surcharges have rebounded nicely of late, hitting bottom in May at \$.34 a pound and closing for November at roughly \$.76 a pound. In addition, there have been three base price increases announced since April, all of which have held. We expect pricing to level off at what we believe to be at more than respectable levels in the fourth quarter.

In closing, it is still tough out there and the fourth quarter is typically challenging and we expect this one will not be any different. Producers matching production to demand and exercising price discipline is of the utmost importance to all for our success. Something for all of you to consider. With the drawdown in inventories throughout the entire supply chain to historical lows, along with the reduction of capacity at the producer level and their ability to export, as well as reduced imports due in part to the weak dollar, it would not take much of an uptick in demand to get this ball rolling and very quickly. Just a thought.

Now I will turn the program over to Karla to review the financials.

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

Thanks Gregg. In the 2009 third quarter, our tons sold decreased 26.4% from the 2008 third quarter and 0.7% from the 2009 second quarter. On a same-store basis, which excludes our 2008 acquisitions including the PNA Group that we acquired in August 2008, our 2009 third quarter sales were \$1.0 billion, with our tons sold down 32.9% from the 2008 third quarter and up 2.0% from the 2009 second quarter. Our average selling price per ton sold in the 2009 third quarter was down 34.1% compared to the 2008 third quarter and flat with the 2009 second quarter. On a same-store basis, our 2009 third quarter average selling price was down 29.5% from the 2008 third quarter and down 1.0% from the 2009 second quarter.

For the first nine months of 2009 our sales of \$4.0 billion were down 38.5% from our record 2008 sales of \$6.6 billion for the same period. This includes a 12.7% decrease in tons sold and a 28.6% decrease in our average selling price per ton sold. On a same-store basis, our tons sold were down 35.2% and our average selling price was down 17.5%. According to MSCI data, tons sold for the first nine months of 2009 were down about 41% for the industry compared to 2008.

Our average selling price declined mainly because of the significant cost reductions for most carbon products that we sell from the peak levels reached in 2008. Our 2009 product mix also contributed to our lower average selling prices. Carbon steel products, which typically sell at lower prices than most of our other products, represented 56% of our 2009 nine-month sales compared to 53% of our 2008 nine-month sales, mainly due to our August 2008 acquisition of the PNA Group.

Our 2009 gross profit margins⁽¹⁾ improved significantly in the 2009 third quarter compared to the prior quarters of the year, mainly because our current inventory costs are substantially in line with current replacement costs. Earlier in the year we were selling higher cost inventory into a declining price market that significantly pressured our gross profit margins. In the 2009 third quarter, we were in an environment of improving prices and we began purchasing more metal from mills at current replacement costs as our inventory levels better matched our shipment levels. Our 2009 third quarter gross profit margin was 28.7%, compared to 24.3% in the 2008 third quarter and 22.8% in the 2009 second quarter. For the 2009 nine months, our gross profit margin was 24.6%, compared to 25.9% in 2008.

Because of the significant decline in our inventory costs and quantities in 2009, especially for carbon steel products, we recorded a LIFO adjustment in the 2009 third quarter that was a credit, or income, of \$67.5 million, compared to LIFO expense of \$79.0 million in the 2008 third quarter. In the 2009 nine month period we recorded a LIFO credit, or income, of \$217.5 million, compared to LIFO expense of \$136.5 million in the 2008 nine-month period. Our current estimate for our 2009 annual LIFO adjustment is a credit, or income, of \$290.0 million. Our LIFO adjustment is included in cost of sales.

Because of the significant decline in business activity levels beginning in late 2008, we have aggressively reduced our warehouse, delivery, selling, general and administrative expenses. Our 2009 third quarter expenses are down \$76.1 million, or 23%, compared to our 2008 third quarter expenses. Our 2009 third quarter expenses were 20.2% of sales, compared to 12.7% in the 2008 third quarter.

Our cost structure is highly variable, with about 60% of our expenses personnel-related. In 2009 we have reduced our headcount by just over 1,600, or 15%, with most reductions occurring in the first six months. Since September 30, 2008, we have reduced our headcount by over 2,400, or 21%. In addition to the headcount reductions, we have several employees working reduced hours resulting in additional savings. Further, throughout our workforce, employees have a significant portion of compensation tied to profitability. Because of the lower profitability levels in 2009 our compensation expense has declined.

Our 2009 depreciation and amortization expense of \$89.9 million increased 28.7% over 2008 mainly due to our 2008 acquisition of the PNA Group and due to the depreciation of our capital expenditures made since September 2008. Our 2009 third quarter amortization expense increased from the 2009 second quarter mainly due to the write-off of \$1.6 million of capitalized financing costs related to our term loan that we paid off and terminated in late September.

Our operating income for the 2009 third quarter was \$74.3 million, or 6.0% of sales, compared to \$269.2 million, or 10.5%, in the 2008 third quarter, and \$5.4 million, or 0.4% in the 2009 second quarter. Although lower sales volumes combined with compressed gross profit margins significantly reduced our operating income margins in 2009 compared to 2008, our operating profit in the 2009 third quarter is the strongest we have experienced this year. Interest expense for 2009 of \$51.9 million declined 8.4% compared to 2008. In August 2008 we significantly increased our borrowings for the \$1.1 billion purchase of the PNA Group. However, we have been able to quickly reduce our borrowing level because of our strong cash flows over the past twelve months as we have aggressively reduced our working capital levels to better match current business activity.

Our effective income tax rate for the 2009 nine-month period was 31.1% and it was 31.6% for the 2009 third quarter, compared to 37.6% in the 2008 periods. Our lower rates are mainly due to lower taxable income levels in 2009. In the first nine months of 2009, we generated a record

\$807.2 million of cash flow from operations, compared to \$115.4 million in the 2008 period. In the 2009 third quarter, our cash flow from operations was \$125.9 million. Our accounts receivable balance decreased \$266.5 million in 2009. Our average accounts receivable days sales outstanding rate at September 30, 2009 was about 42-1/2 days compared to 42 days at December 31, 2008, and down from 43-1/2 days at June 30, 2009. In the first nine months of 2009 we wrote-off \$16.3 million of customer receivables as uncollectible. Our full year 2008 write-offs were \$8.1 million. Our allowance for uncollectible accounts at September 30, 2009 was \$21.3 million, which we believe is adequate to absorb any further losses.

Our inventory turn rate for the first nine months of 2009 improved somewhat to 3.5 times compared to 3.4 times in the first half of 2009. Our 2008 inventory turn rate was 3.9 times. As of September 30, 2009, our inventory tons on hand were down 32.8%, and our FIFO inventory balance was down \$709.8 million, or 42.5%, from December 31, 2008. In the first nine months of 2009, we spent \$55.0 million on capital expenditures. Our 2009 capital expenditure budget is \$95 million. We also continue to pay our regular quarterly dividend which is about \$7.3 million per quarter.

Our outstanding debt at September 30, 2009 was \$1.07 billion, down from \$1.77 billion at December 31, 2008 and \$2.28 billion at September 30, 2008. Over the past twelve months, we have paid down over \$1.2 billion of debt with cash flow from operations and built cash of about \$88 million. Our net debt-to-total capital ratio at September 30, 2009 was 28.3%(2), down from 41.4%(2) at December 31, 2008 and 48.1%(2) at September 30, 2008. The covenants in our debt instruments primarily relate to maintaining a debt-to-capital ratio of less than 60% and an interest coverage ratio of at least 3 times. Our interest coverage ratio at September 30, 2009 was 3.3 times(3).

On September 28, 2009, we amended our \$1.1 billion credit facility mainly to adjust our interest coverage ratio requirement. With the amendment, our pricing was adjusted to market rates and restrictions were placed on certain uses of cash. The adjustments to our financial covenants and cash restrictions are in place until June 30, 2010. With the amendment of our credit facility, we also extended our term by one year from November 2011 to November 2012 for \$1.02 billion of commitments. Concurrent with the amendment and extension of our credit facility, we also paid off the remaining balance on our term loan of \$444 million with \$194 million of cash on hand and \$250 million of borrowings on our term loan.

We have \$146.5 million of debt obligations coming due before our credit facility expires in November 2012. We are comfortable that we will have adequate cash flow and capacity on our revolving credit facility to fund our debt obligations as well as our working capital, capital expenditure, growth and other needs.

Thank you. We will now open the call for questions.

Regulation G Reconciliations

- (1) Gross Profit, calculated as Net Sales less Cost of Sales, and Gross Profit Margin, calculated as Gross Profit divided by Net Sales, are non-GAAP financial measures as they exclude depreciation and amortization expense associated with the corresponding sales. The majority of our orders are basic distribution with no processing services performed. For the remainder of our sales orders, we perform "first-stage" processing which is generally not labor intensive as we are simply cutting the metal to size. Because of this, the amount of related labor and overhead, including depreciation and amortization, are not significant and are excluded from our Cost of Sales. Therefore, our Cost of Sales is primarily comprised of the cost of the material we sell. We use Gross Profit and Gross Profit Margin as shown above as measures of operating performance. Gross Profit and Gross Profit Margin are important operating and financial measures, as fluctuations in our Gross Profit Margin can have a significant impact on our earnings. Gross Profit and Gross Profit Margin, as presented, are not necessarily comparable with similarly titled measures for other companies.
- (2) Net debt-to-total capital is calculated as total debt (net of cash) divided by Reliance shareholders' equity plus total debt (net of cash).
- (3) Interest coverage ratio is calculated as net income plus interest expense and provision for income taxes, less equity in earnings of unconsolidated subsidiaries, divided by interest expense for the latest-twelve months.

This conference call may contain forward-looking statements relating to future financial results. Actual results may differ materially as a result of factors over which Reliance has no control. These risk factors and additional information are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 and other reports on file with the Securities and Exchange Commission.

Oct. 22, 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

QUESTION AND ANSWER

Operator

(Operator Instructions). Timna Tanners.

Timna Tanners - UBS - Analyst

Hi. It's Timna with UBS. Good morning. Thanks so much for all the great color. I hope I caught it all.

I really want to reconcile what David said in the beginning regarding the inventory position, 2.5 months on hand. I was a little surprised because that's higher than what we've seen with MSCI, so if you could help us understand that.

And then along the same lines, I was kind of surprised that you talked about working down inventories further into the fourth quarter, and then Gregg's comment about how we could see the ball rolling quickly with the supply getting drawn down. So how do you reconcile working down inventory if you're concerned that there could be a sharp change in market conditions into next year?

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

I think at first off the -- we are not real -- we don't anticipate that there is going to be a quick uptick in the fourth quarter, or maybe even early in the first quarter, because typically that doesn't happen. March is kind of the month that is the big catalyst. And that's what we have looked towards.

But that doesn't mean that we wouldn't see some improvement over the lower activity in November and December of this year that would occur in January, say, of next year. We even saw that last year when things were deteriorating. We saw January pick up.

I think that we still have 2.5 months on hand, with respect to tons, and that's based on September shipments. The turn number that Karla gave you is based on an annual amount, so -- and it's based on dollars as opposed to tons. But with the pricing changes this year, we have tried to really manage our inventories with more tons in mind and what that represents.

We still have some areas where we need to work down some tons. Some of our businesses are turning six, eight, 10, 12 or more times, depending upon their products. But we have some that are still turning below where we would like them to be. So those are the places where we believe that we can still get some more money out of our inventories, more tons out of our inventories.

Also the dollars that we are thinking will come out of inventory are mainly due to -- even if the tons stay the same, we are replacing those tons with cheaper prices today than what we are selling at this time. So the net effect of that is to have inventory reduced.

In terms of being afraid of what happens when the market picks up if we are low on inventory -- we just don't think we are low on inventory. We are used to running our company with -- before some of the acquisitions we have made, with two months on hand. We always had a target of six turns. But since the Jorgensen acquisition and the PNA acquisition, and the nature of their products, I think our sites are more towards the 5.00 to 5.25 turns, which is about 2.3 or 2.4 months on hand.

And we just feel that with our supply being almost exclusively domestic, and certainly today, and the relationships that we have with our mills, that we are not going to have a problem getting metal.

Gregg, you might have something.

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

You saw the price reductions that were announced last week on carbon steel products. We used to think that scrap has a better potential than not of going down again in the December time frame. So we are anticipating some reduction in our cost of goods going forward through the quarter.

Oct. 22, 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

Because of that we are going to keep our inventories lean so they don't get hurt as bad if we've maintained at the present level. So that's one of the reasons for us looking at reductions in inventory.

And we always -- every year we have a very, very strong cause to get our inventories down to record levels by December the 31st. This year is no different. We are going to continue to do that.

My remarks with regard to some improving fundamentals out there, or possible improving fundamentals out there, were more directed towards what would be taking place sometime in the first part of the year, first part of the -- or second part of the first quarter, I should say. So I think the stars are aligned that it's possible that we could see some very, very positive things happen with respect to an uptick in pricing, provided we get just a small uptick in demand. So my comments were not directed towards the fourth quarter.

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

Also just quickly on reconciling to the MSCI data, I think you need to remember that the MSCI data has quite a bit of flat rolled carbon inventory in it that influences their number. And at Reliance flat rolled carbon makes up a very small portion of our inventory.

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

I was just going to follow on what Karla said. Our carbon turn is -- we have way over six in terms of our carbon flat roll. So that would be a bit less than two months on hand for sure.

Operator

Michelle Applebaum.

Michelle Applebaum - Steel Market Intelligence - Analyst

My affiliation? I vote independent, typically. Steel Market Research. Pardon me, Steel Market Intelligence.

What Gregg was saying is that you were hoping for a pickup in the late first quarter. You're talking about the normal seasonal pickup that we generally see starting in February?

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

Yes.

Michelle Applebaum - Steel Market Intelligence - Analyst

I just wanted to clarify that.

Is there anything in particular going on that makes you think that that would happen this year? Or are you saying you have visibility until just about January at this point and don't see a pickup yet? But it could come after the visible period?

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

Our visibility really is day-to-day by the nature of our business. So we have little visibility other than the conversations that we have with our customers, who generally have a backlog as compared to our companies for the most part not.

But we are seeing more quoting activity, we are -- our customers are basically very cautious about their approach to the fourth quarter. But there is some encouraging signs from their end that things will get better.

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

Well, what does that mean? Getting better from what part? Where is the basement at? So I think that there is a potential for not only the seasonality improvement, but there might be the potential for some just extra demand coming about in that March/April time frame. So we are hopeful that's the case, and if that is the case, I don't think there would have to be much of an uptick for us to see a fairly significant increase in pricing and lead times extending out, if that should take place.

Operator

Mark Parr.

Mark Parr - KeyBanc Capital Markets - Analyst

Thanks. It's KeyBanc Capital Markets. Good morning. Hey, good job again, as usual.

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

Well, better than the second quarter, we'll say that. Not where we would like to be, but given the conditions out there, I guess we have to be satisfied.

Mark Parr - KeyBanc Capital Markets - Analyst

Making progress. Blocking and tackling. One thing I think I missed -- Karla, you made some comments about charge-offs in the third quarter. You said your reserve was \$22 million. What's the change there relevant to the end of the second quarter?

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

It's down about \$500,000. It was like \$22 million down to \$21.5 million.

Mark Parr - KeyBanc Capital Markets - Analyst

All right.

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

But that was the -- that's the reserve. So our write-offs in the quarter were just over \$5 million.

Mark Parr - KeyBanc Capital Markets - Analyst

Okay. All right. So you had -- and would you -- we were looking -- the SG&A number looked like it picked up a little bit more than what you might have indicated maybe a month or so ago. I'm just wondering if there's anything unusual in the SG&A number that might not repeat in the fourth quarter, or what color you could give us as far as fourth-quarter SG&A is concerned.

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

So we were up around \$3 million to \$4 million in SG&A expenses, Q3 to Q2. There was -- a little bit of that was related to a reserve that we increased a little bit, just for some potential legal costs. And then the other part of it was that because we were fortunate enough to increase gross profit margins and profitability at some of our companies, we were paying some commissions and small bonuses in the third quarter that we didn't see in the second quarter.

Mark Parr - KeyBanc Capital Markets - Analyst

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

So would you (multiple speakers)

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

So for fourth quarter, it should be I would say more similar to a Q2 number.

Mark Parr - KeyBanc Capital Markets - Analyst

That is helpful. And then as far as the tax rate for the fourth quarter, should I think about a 32% kind of a number?

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

That's a good question. Yes. I am looking at probably 32%. We will have our true-ups at the end of the year. We typically in the fourth quarter see a little bit of a fluctuation, kind of like LIFO, where we true everything up at the end of the quarter. But I think 32% is a reasonable assumption.

Mark Parr - KeyBanc Capital Markets - Analyst

And then the true-up on LIFO you made implies about a \$72 million to \$73 million LIFO credit for the fourth quarter. Is that right?

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

Correct.

Mark Parr - KeyBanc Capital Markets - Analyst

So that's a little bit lower than what we had, but not that much.

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

Yes. It's basically -- it was before \$75.0 million down to \$72.5 million based on our current annual estimate of \$290 million. And again, when we get to the end of the fourth quarter that will get true'd up. So it might come in at \$288 million. We might come in at \$310 million. We don't know. But it will be the actual and now as of that time.

Mark Parr - KeyBanc Capital Markets - Analyst

Right. Okay. That's helpful. If I could ask one more just real quick question, and this would be more for Gregg and Dave. I wonder if you are seeing anything from a mix standpoint. You had talked about a little bit of margin, FIFO margin pressure relative to 3Q, and that's kind of normal. I didn't know if there is anything on the mix side that might make that worse or make that a little better. What would -- is there that we could take away from that standpoint?

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

I don't think we are anticipating any change in the mix from the third quarter. There's nothing really different that we are expecting in the fourth quarter, other than your typical less number of shipping days, lesser number of shipping days.

Mark Parr - KeyBanc Capital Markets - Analyst

Oct. 22, 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

I was thinking about in terms of that perhaps continued weakness on the non-res construction side and some upside on electronics and some of the defense aerospace businesses.

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

Yes. That's kind of an extension on what we are seeing right now. The aerospace business has been the stronger of what we -- strongest of what we have, and we expect that to continue through the fourth quarter. It may soften a little bit, but it's still going to be our best performer.

I think the oil and gas and energy side looks to be pretty consistent.

The semiconductor and electronics is actually accelerating a little bit, so we would expect the business in that area to be a little better in the fourth quarter, particularly on a daily basis when you factor in the number of days.

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

Yes. And the regions that are affected there primarily are California and the northeastern markets.

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

And then as far as the non-res/infrastructure, we're just anticipating that it continues to limp along just like it is currently. So no real change but just kind of bumping along.

Mark Parr - KeyBanc Capital Markets - Analyst

Okay. All righty.

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

We have seen -- we should say and we haven't said yet that we are seeing that public projects are out there. So in addition to what Gregg had mentioned on the bridge work and barge work and those kinds of things, that there is activity, we are also seeing a fair amount of activity in schools and hospitals and other municipal projects that are really financed with bond funds that have been raised specifically for those projects.

So despite the fact that the state of California isn't in great shape and a lot of the other states aren't in very good shape either, there are these bond funds that are out there, and they are in place, and they're ready to be spent, and they are being spent. So we are seeing activity in that end of the non-res section.

Mark Parr - KeyBanc Capital Markets - Analyst

And just one final point of clarification. Your sales per day probably increased as the quarter progressed, because July was so weak.

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

Yes.

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

Yes.

Mark Parr - KeyBanc Capital Markets - Analyst

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

And so when we think about the fourth quarter, should we think about the September number carrying through, or should we think about the number perhaps coming back down in December to where it was in July?

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

We hope not. But not on a daily basis, I don't think. Because we've actually -- the margins are better, the prices are better today than they were in July, despite the fact that we may have some slight pressure if scrap comes down, but that's kind of normal price changing that we are used to dealing with in our industry and in our company on a regular basis.

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

I think what happens is, Dave, the only difference is how many days do people really believe are shipping days.

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

Yes. Well, and that's -- yes. And that's -- we are talking on a daily basis, so not -- and it depends, again, like Gregg said, December you can count the days between Christmas and New Year's as legitimate shipping days, but are they really?

But I think you know that. So yes, the revenues per day that we had during the last quarter, they were down in July compared to June, which we had put out in our July release. But then our average sales per day were up about 7%, as I mentioned earlier, in August and over July and on a daily basis up a little over 5% in September compared to August.

So -- but it all comes out in the quarter to be flat, because the third -- or the second quarter went down, down, down.

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

Yes.

Mark Parr - KeyBanc Capital Markets - Analyst

Okay. All right. Well look, I really appreciate that color. And congratulations on the great job you guys keep doing in this environment.

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

Thanks Mark.

Operator

Michelle Applebaum, Steel Market Intelligence.

Michelle Applebaum - Steel Market Intelligence - Analyst

I wanted to ask you, you said something in your prepared remarks about hoping that the mills keep prices the same, and I was just wondering, could you repeat that, Gregg? You went really fast.

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

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

Intentionally, Michelle. Just kidding. I guess what we are trying to say is that as long as -- I think I went over about the ebb and flow of the scrap. Just recently, as you know, last week there was a price discount announced on many of the carbon steel products of a \$30 a ton discount, which followed scrap to the tee. I think if we continue to do that that would be very healthy for everyone in the metals business.

And I just don't believe if there was any radical move, as there was last year on one occasion in October, and if there was another one -- a couple of them done in the first half of this year -- which really generated absolutely no tons for anybody. The tons were still there, I don't think anybody's order book improved in any way, shape or form. It's just that we all bled a lot more because of the discounts were so significant. And it gained absolutely nothing except red ink.

But I think really that was my point. I am hopeful that the mills will do the same thing going forward because we -- I think we all anticipate scrap will go down one more time this year. And it would be nice to -- comforting, I should say, that if we just leveled it off.

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

Just limit any price adjustments to whatever happens with the scrap. So essentially what he's saying is we would like not to see any base price adjustments other than just what happens with the scrap surcharge.

Operator

Timna Tanners, UBS.

Timna Tanners - UBS - Analyst

Thank you for taking the follow-up. Just wondering, should we interpret the direction of the cost cutting and the overhead as maybe being more - or should I say less to do there? Do you think you've seen most of the cuts to the overhead that you think that you will see?

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

Yes. We had also commented on that at the end of the second quarter that we thought we were pretty much through that. We've cut pretty deep into our workforce, so we think we're -- for current demand levels, we think we are at a reasonable rate with not much more to take out. If there would be a significant drop-off, we would have to reassess that, but we don't anticipate that at this point.

Operator

Tim Hayes.

Tim Hayes - Davenport - Analyst

Davenport & Company. Good morning. Just wanted to further ask on the LIFO -- or excuse me, the FIFO inventory reduction that you expect in Q4, you said you expect to bring that down further. In relation to Q3, since Q3 was brought down by \$92 million, do expect that to be smaller than what you achieved in Q3?

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

Yes. It's not going to match that. I think every quarter has been going down and down, and we are getting pretty close to bottom. So although we do believe that there will be some, I am not comfortable to give any number with that.

Tim Hayes - Davenport - Analyst

Sure. Yes. It seems like that would be the case, given that the metal price has started to move higher during the summer months.

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

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

Sure.

Tim Hayes - Davenport - Analyst

And so assuming that's going to be smaller, and the question is by how much, do you then expect her LIFO inventories to actually go up in value from Q3 to Q4?

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

Based on the way that we record our LIFO adjustment, no. We basically said our current annual estimate is \$290 million, which we have to bring into income ratably over the year. We are, based on our actual calculations of LIFO, we are basically at that point. And anticipating that in real activity in the fourth quarter, it's kind of a net push because some of the higher cost inventory from the mill prices that were announced in the third quarter, we'll receive in the fourth quarter, but we'll also continue to reduce our quantities, and we had some higher cost inventory, small amounts, still in there. So we're looking at kind of a net push, even though based on the accounting rules we expect to bring in about \$72.5 million of income from LIFO in the fourth quarter.

Tim Hayes - Davenport - Analyst

Thank you.

Operator

Yvonne Varano.

Yvonne Varano - Jefferies - Analyst

Jefferies. Just a little bit of follow-up on that. I would guess that with all that going on, we would probably see your gross margins come down a little in 4Q from what we saw in 3Q?

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

I think I mentioned that, yes, that we wouldn't be surprised that margins might come down a little bit from the level that we just reported for Q3.

So in Q3 we had the support with the mill price increases, which always helps on our margins, and I think -- those increases we don't think will be there during the fourth quarter. So -- and we are not that concerned about the decreases and the impact on the margins because they are not that big -- or at least those that we anticipate. If what happens is what Gregg is hoping to happen.

So yes, the margins might tighten just a little bit.

Yvonne Varano - Jefferies - Analyst

Just, Gregg, I know you mentioned regionally California and the Northeast. We know the Midwest is pretty weak. But any commentary you could offer on some of the other regions?

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

Oct. 22, 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

Yes. And that was actually specifically directed to the semiconductor and electronics. Just so we're clear on that.

But no, we are seeing just about the same activity throughout all the different regions within the country. There's really no reason that that's incredibly busier than -- I wish there was, actually, but it's pretty consistent.

We have a little bit in the Pacific Northwest where it's a little bit more difficult than others, but Midwest is holding up, Southeast is holding up, California is doing okay. It's all relative, I guess. But I guess if you were to put a brush on it, they're all pretty much close to one another by way of average daily sales, profit margins, expenses, etc.

Yvonne Varano - Jefferies - Analyst

Sure. And then I just wanted to ask on plate specifically whether you think you're going to see the pricing pressure on that product going into year-end, because I've heard it's holding pretty well.

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

It has held pretty well. We don't expect -- if any product -- let me put it this way -- if there's any product in the carbon steel area that has more strength than others, it would be carbon steel plate. And I believe the mills -- I'm not a mill executive or anything, but I would say it's probably one of their sacred cows. They probably make a pretty good profit margin on the plate, I would guess. And if that is the case and we were a part of that team, we would want to keep that up as best we possibly could too. So I don't think the pressure there is going to be as great as it would be with some other products. I hope not.

Yvonne Varano - Jefferies - Analyst

Yes.

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

It's a good product for us too. Trust me.

Yvonne Varano - Jefferies - Analyst

That's what I figured. Thanks very much.

Operator

Sal Tharani.

Sal Tharani - Goldman Sachs - Analyst

Goldman Sachs. Just wanted to get some color on your volume for the quarter, which appears to be a little weaker than what we thought, because activity in the third quarter really hadn't picked up. I see that the service center shipments were up also 6%. Granted, a lot of it was flat roll, but is that something particular happened that even though August and September were so strong that July it fell off sharply? Or you didn't see much fall-off in the beginning of the second quarter, which held up the volume in the second quarter much better?

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

I'll mention something, and then Dave can jump in here. We made a concerted effort within our company in the third quarter. We met with all of our managers early in July and said, liquidation of inventory and all that has been a necessity for the nine-month period prior to the beginning of

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

the third quarter, and right now we've got to get back in the saddle again and start increasing prices and selling things for a profit rather than liquidating our inventories.

Now that means we are going to be sacrificing some volume. And if that's the case, we've done it before, we are back to managing our company for profitability purposes, not for liquidation purposes.

So I think the reason -- the key reason for us to lose some volume in the third quarter compared to the second quarter was exactly what I just stated. We were more profit-driven, we've walked away from business that we would have taken if we had to get rid of inventory. And we took the high road and increased our margins by 6.5% on a FIFO basis -- a LIFO basis -- a FIFO basis -- I beg your pardon. And I think we've made a heck of a lot more money with that increase than the slight decrease that we had in volume.

Is that fair, Dave?

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

Yes.

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

Yes. I think also you just have to remember our mix, as you said, a lot of the pickup was in flat rolled, and we've only got about 10% to 11% of our volume in flat rolled -- carbon flat rolled products. We do have a lot of our business with the non-res construction market, which we know there's pressure on that.

But you also have to look back at the second quarter. And during that quarter our volume on a per day basis was declining. Every month, it got worse -- April, May, June. July actually got worse than June and was our low point, and then we did start to see, even with our focus on gross profit margin, we did start to see some volume pick-up in August over July, and September over August. So we were actually happy with the volumes that we saw during the third quarter, and they were a little better than what we had expected.

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

And then when you put that into what Gregg said, our focus on -- change in focus on trying to make some money and less on cash flow, when you look at the average daily sales, why we think third quarter was a real positive is you look at average date of shipments in revenue dollars, in the first quarter it was down 28.4% compared to the fourth quarter, which is unbelievable. And then in the second quarter compared to the first quarter we were down 21.5% in sales per day.

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

And that's normally our strongest quarter.

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

That's normally the strongest quarter. And then in this third quarter we were actually even. We were up 0.03%, but that, in our minds, was a great sign that particularly when you look at the months in the quarter, the changes that we saw in August and September.

Sal Tharani - Goldman Sachs - Analyst

That's great color, thanks. Can you -- you made a comment that we know that service centers haven't built too much inventory, we can see the data. But you also mentioned that you don't think customers or end-users are building much inventory. Can you just give us some color. Do you think that most of this demand increase has been actual, final demand increase in the markets?

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

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

Well, I think from our shipments I think that has been true because our customers for quite some time have been doing what we have been doing, and that's living out of their inventories. And now they are starting to order again, certainly far from their -- whatever their normal order patterns were in the past. But at least they are ordering something now where they either have holes to fill and because they've run their own inventory down. And they are still doing something. So even to match their order patterns with the lower levels of demand that they have for their products is a positive thing for us, where for quite a while the same thing was going on there as we were doing. They just weren't ordering.

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

We had customers that were off 50%, 60%, 70% in the first half of this year compared to the first half of last year. And it wasn't because we were losing market share, it was because they were assuring us that they had parts in stock, already machined and whatnot, that they were told by OEMs they needed to hold on to, so they were basically not buying anything, shipping what they had already produced. And now they are getting back into that mode where all of a sudden the last -- basically the last two, three months they've actually been ordering for purchases that they need to manufacture something rather than ship them inventory out of stock.

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

Yes. We've heard a lot of this restocking word that's being thrown on out there, and I guess it kind of depends upon what your definition of restocking is. In our minds restocking is kind of wholesale restocking of your shelves. And we don't see that going on, certainly at our company, we don't see it going on in our industry, and we don't see our customers doing that either.

But are we buying more? And are others in our industry buying more from the mills? Yes. Because we've worked our inventories down, we've bought from each other for the better part of nine months. And our customers are doing the same thing. So there's not a wholesale restocking going on, but there is some increased order activity because of them having worked through their own inventory.

So I guess the long answer to your question is that, yes, I think the activity that we have seen relates to demand, kind of the new, low levels of demand that we are seeing right now.

Sal Tharani - Goldman Sachs - Analyst

Thank you very much.

Operator

Luke Folta.

Luke Folta - Longbow Research - Analyst

This is Luke Folta from Longbow Research. I just had a question regarding your margins in the quarter. Just trying to get a feel for what the impact was from the increased selling prices. I'm just trying to normalize margins for the quarter.

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

That's a tough question for us to answer because at the same time that prices were kind of at least lending support to our sell prices, the increase in mill prices, probably a bigger factor in that in our margins was actually the reduction of our inventories, and the reduction of the high-cost inventories in particular. Do you have a guess at that, Karla?

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

Well, I'm not going to give you a number, but we had talked about in the second quarter how we had started to see our FIFO gross profit margin improving every quarter because of -- a lot of it because of our inventory costs being more in line with current costs. That trend continued in each

Oct. 22, 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

month of the third quarter. Basically our 6 percentage point increase in FIFO gross profit margin was spread out evenly, July, August, September. So you can factor in what you think was happening with mill pricing during that period. We don't expect from an inventory cost standpoint to necessarily continue that trend of 2 percentage point improvement a quarter. Part of that was coming from the kind of mill price increases that were out there. So I think you can make your own assumptions to kind of level off.

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

Yes. Our FIFO gross profit for the quarter was 23.2%, and that was up from 16.7% in the second quarter and 23.2% is -- somewhere near there, I would guess, would be sustainable. It could be a little less. It could be a little better.

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

Yes. In a more normal environment, 23% FIFO GP margin is low, but we are not in a normal environment yet.

Luke Folta - Longbow Research - Analyst

I guess I was just trying to get to the point where you guys probably aren't going to give a whole lot of that gross margin improvement that you achieved a quarter or quarter back.

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

We hope not.

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

We better not. Yes.

Luke Folta - Longbow Research - Analyst

I just had one more follow-up regarding just the overall environment for M&A. Is that -- I mean, have we seen any improvement there? Or any more willing buyers? Or any color you can provide?

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

There's really not much activity out there. There are some things that are being marketed, just two or three things that are out there. There is nothing that we have seen that is attractive to us. I think there are more distressed situations, and those are not the kinds of companies that we like to acquire. So from our perspective, for what we like, there is virtually no activity out there at this time.

We think that it's probably going to stay like that for at least six months after we see some real demand improvement. And so if we start to see some better real demand improvement late in the first quarter of next year, hopefully, then sometime in the second half of next year we would expect some M&A opportunities to present themselves. But nothing right now.

Luke Folta - Longbow Research - Analyst

Great. Thanks a lot guys.

Operator

Tony Rizzuto.

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

Tony Rizzuto - Dahlman Rose - Analyst

Dahlman Rose. Most of my questions have been covered already, but I wonder -- we read and hear so much about the tightness in credit out there. I was wondering if you guys could comment about the -- how the tightness in credit may be affecting your customer base.

Then I've got another question as well.

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

We've seen certainly some examples of some of our customers not being able to get their credit increased or renewed. Those were probably some of the weaker customers. I don't think we've seen it at the level that it's been as much of an impact as you might believe, from different media reports that are out there.

We have seen this time, our write-offs are up, we have seen a lot of our customers close their doors. Interesting this time is that a lot of people have not gone through the process of filing for bankruptcy, they've basically just closed their doors and left, which -- at a much higher rate than we normally see that, so as our credit manager says, they don't even have the courtesy to do a bankruptcy filing.

So -- and we have a lot of small customers out there. You've got to remember that too. So credit has been a factor. We actually think that when things start to improve and people need to increase their working capital, especially because a lot of companies are on secured or asset-based loans, we think we will probably see more of an impact from the credit, if it's limited at that time, than we have seen so far.

Tony Rizzuto - Dahlman Rose - Analyst

Thanks Karla.

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

I might add something to that. It's interesting, because our sales to our -- to other service centers, smaller to midsize service centers, has increased rather dramatically over the past -- since the beginning of the year. It's -- frankly it's been a very -- it's a big positive for us. But rather than spending \$20,000 on a truckload or something, that they can buy it in smaller quantities from us and spent \$3,000 here, \$5,000 there. The activity that we have gotten from other, smaller to midsize service centers because of cash flow and the credit facilities and whatnot has actually been very positive for us. So that's just a side note.

Tony Rizzuto - Dahlman Rose - Analyst

That's a -- certainly some light at the end of the tunnel, definitely. Gregg, I got another question for you too though. And one of my favorite topics here on the heat-treated alloy plate side, you made some comments about the demand continuing to remain pretty lackluster right now. Do you see anything on the margin that it's maybe taking or going to take another leg downward? Or do you see just kind of status quo?

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

Margin meaning our margins? Or do you think the mills will take a haircut and maybe drop their price a little bit?

Tony Rizzuto - Dahlman Rose - Analyst

I'm saying the latter, more the latter.

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

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

Yes. I think the potential is for it to go more down than up. I think that the mills are exercising as much discipline as they can given the demand standpoint.

You know one of the things, the take or pay programs that they have out, which you are familiar with?

Tony Rizzuto - Dahlman Rose - Analyst

Yes.

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

That can be beneficial in the short term. But in the long term I'm not so sure it's good for the mill, the producers, or the service centers, because it just forces people to take in and then dump in the marketplace and then cut all their purchases back that they would normally have been doing on a more consistent basis. But if there is -- if you were to throw a coin up in the air and say, heads or tails, it's going to go up or down? It definitely has more downside potential than up.

Tony Rizzuto - Dahlman Rose - Analyst

And just one final one here, very quick. What price are you guys seeing right now for hot rolled coil out there in the market? We've been hearing quotes around 530, 540. Is that what you guys are seeing?

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

Yes, we are seeing more 540. If you threw some tons out there, you're going to get 520, 530. But I am not sure anybody's really doing that, more people. I know that we are not. So if I was to plug a number into a model, I'd say 540.

Tony Rizzuto - Dahlman Rose - Analyst

All right Gregg, thanks so much. And I appreciate all of your insights. Thank you.

Operator

Wayne Atwell.

Wayne Atwell - Casimir Capital - Analyst

Casimir Capital. Thanks for all your color on the industry.

I was going to ask you about M&A, but you answered that question. Could you -- let me throw up an open question -- or a broad question. Can you sort of describe how the industry is going to change in the future versus where we were? Obviously we've gone through the worst correction we've had in 40, 50 years. Is this going to be beneficial to you, i.e., your competition is going to be diminished? Or even if they are still around, they're going to be crippled? Your customers will be maybe fewer and larger? Or can you sort of describe what you see going forward versus where we have been?

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

Yes. I think -- we've been through some other downturns but certainly not like this one. So what we have seen coming out of other downturns, more recently 2001, '02 and '03, is there was increased interest by a lot of the privately owned service centers to sell their companies and protect their families' wealth and gain some liquidity for their estates. And our feeling is that that's going to happen again and that it won't really start to

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

pick up until after we have seen some improvement in business conditions, because people don't like to talk about selling their company when they have a lot of red ink on their financials.

But we also think that different this time is the credit environment that Karla was alluding to. And the same thing for people in our industry as we expect in our customer base, that when business conditions do improve, and they will -- when they do improve, there is going to be a need for capital to fund -- working capital increases, if nothing else. And there's probably going to be some need for capital expenditures because a lot of people have postponed capital expenditures during these times. And it's just a natural thing to do. And that capital is going to be much harder to come by now or in the future when business conditions improve than ever before.

So I think that's going to cause a lot more activity on the M&A side. So I think we will see our industry consolidates some more. I think it needs that, even in our size. We are only 6% or 8% of the market, so it's still very fragmented. I think there's room for consolidation, and I think that will happen. But not until business really starts to pick up, and then we are going to see that added pressure for capital.

Other than that, I think the customer base, we are -- they're still going to keep things going. It's going to be a while before we get back, if we get back, to the levels that we were at in 2007 and in '06 and maybe the earlier part of 2008.

I think most of us have learned in our industry, again, or we have been reminded, if we didn't -- had forgotten about it, how important inventory management is in this volatile environment. And this has been the most volatile we've ever seen. So I think maybe people who used to stick it out there a little bit farther and speculate a little more are less apt to do that. So I think that should be a benefit to our domestic mills and certainly makes for a healthy industry -- a healthier industry.

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

I have a comment to make about service centers in general. Our approach has always been to manage our inventories and just turn our inventories, collect our receivables as best we can. Because we think that's probably the least amount of risk when you go into declining markets. So you may not make as much if you are speculating and you hit it right, but you're not going to lose as much either because if you were speculating and even if you did hit it right and prices drop, you're going to get killed.

So what I think is going to be a fundamental change in service centers is that they are going to take a look at their business models and they're going to say to themselves, what can I change to try to minimize my risk going forward? Because of the beating that they -- that most of us took in this 2009. If anybody forgets this -- I can't imagine anybody forgetting this, so I would say -- and speaking for Reliance ourselves, our model has been very -- as much risk free as we possibly could get. But we are going to take that to another level, just because these swings that we have seen in '04 going up, '05 going down, '06 going up, '07 going down, '08 going up, '09 collapsing -- these swings could actually get greater. And if they are, then you really have to control your risk.

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

One of the benefits we think we have with our size is the fact that we don't have to chase volume. And Gregg talked about that earlier, about sacrificing some volume for profit. And we just don't feel that we have to chase volume. We don't feel that we have to take risk on accounts receivable, which are the two biggest areas of risk for us. And we just don't want to do that. We don't feel we need to do that. We are -- if we lost some business but made some more money, we are perfectly happy with that.

Wayne Atwell - Casimir Capital - Analyst

Great. Well listen, thank you very much for that color.

Operator

Richard Garchitorena.

Richard Garchitorena - Credit Suisse - Analyst

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

Credit Suisse. Just a couple quick questions, I know we are running pretty late here. But most of my questions have been answered. One is in terms of lead times from the mills, what are you seeing right now? Has it been increasing with the recent I guess pickup in shipments over the last couple of months?

And the other one is also on utilization rates, and do you think we are getting a little ahead of ourselves? Where do you see utilization rates getting next year?

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

Well, it depends on the mix. I am assuming you're talking about carbon steel prices; is that correct?

Richard Garchitorena - Credit Suisse - Analyst

That's right. Yes.

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

Yes. The flat roll lead times have gone out quite a bit. Some of the mills are all the way into December and for the most part sold out through December. Others are not. When you get into the other products, whether it be mini-mill, structural, or plate products, or tubular products, it's -- the basic lead times are like four to six weeks.

Now, when you get into the beams, it also depends on rolling schedules for large sections and whatnot, so it would be much greater than that. But it's pretty readily available. Lead times are pretty good as far as the flat roll is concerned. Because of the Cash for Clunker program and some automotive pickup they've got -- they've extended out further. So -- but for the other product mixes other than flat roll, it's pretty much business as -- as it has been over the past few months.

Richard Garchitorena - Credit Suisse - Analyst

Just on utilization rates, close to 60% now, do you think steel mills are in line with demand? And if it goes to 75%, 80%, is that a concern going to 2010?

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

Yes. I think it's always a concern. I think all of us in the business, when we saw some capacity coming on-stream from the various mills and whatnot, we -- in particular I'm referring to flat roll, as a matter of fact, specifically I'm referring to flat roll. All of us were concerned about that. And I think rightfully so.

But on the other hand, we don't know exactly what arrangements they have with the car manufacturers, appliance makers and whatnot. I don't think they'd just turn the switch on to bring on capacity unless there were some commitments being made by some of the large OEM flat roll users. So I guess we have to put a little faith in them, and then I guess if they overestimated what consumption would be, they do have an avenue to export, which has improved with the recent even greater weakness in the dollar. So our hope is if they did overshoot that a little, which is possible, that they do have an outlet other than reducing the price and selling to us.

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

And we also have to keep in mind that they -- the capital -- the capacity utilization dropped to levels that none of us imagined so they've come back up, but -- so directionally they come up, but they are still not at levels that I'm sure the mills would like to be at, and at levels that we would like them to be at, because as Gregg said, we've got to put some faith in their management teams, and they'll to do the right things. If they are making more, then typically they are selling more, which means we are selling more. And that's what we all really need right now is we need some volume and some good solid improvements in demand, because it's still at very low levels. Even though it's better, it's still at very low levels.

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

Richard Garchitorena - Credit Suisse - Analyst

I agree, thanks guys.

Operator

Mark Parr, KeyBanc Capital Markets.

Mark Parr - KeyBanc Capital Markets - Analyst

Thanks a lot. Just real quick, you guys are really doing a great job on this call. This is very helpful, I have to admit. And so, hey, we're on a roll. So why not go for another one? Is October daily sales -- can you talk a little bit about that relative to September?

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

It's tracking about the same as September.

Mark Parr - KeyBanc Capital Markets - Analyst

That's terrific. That's all I had, thanks again.

Operator

Sal Tharani, Goldman Sachs.

Sal Tharani - Goldman Sachs - Analyst

Just wanted to find out what size is the semiconductor electronics business for you guys?

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

It's hard to tell. It's not -- it would be somewhere on the low side, 3% or 4%, and in good times it could probably go up to 6% or thereabouts. But it's not as big as aerospace certainly, at least. It's tough to estimate because it does reach out into a lot of different areas. And if you think about cabinetry, if you think about just 61 plate going into the chambers, vacuum chambers, if you add it all up, I guess it could be close to 10% in a good market. But right now it's probably in that 3% to 5% range.

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

Because it is just starting to heat up. We've seen activity in the semiconductor equipment manufacturers begin to increase at the latter part of this second quarter. And we've seen some steady increases in that industry ever since then. On an average daily sales basis, each month seems to get a little bit better and better. We watch that bill to book ratio of semiconductor equipment manufacturers, and it was as low as -- as a matter of fact, it was the lowest I have ever seen, and we've been tracking that since the low to mid '80s. It was like 0.4 to 1.0, okay. And it's up over -- the last time I looked at was yesterday, and it was 1.17 to 1.00. So for every \$1.00 that they are actually shipping, they are booking \$1.17.

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

We also throw into that area, that electronic semiconductor area, work that goes into the solar industry as well as the LCD panels, which has been dead for nine months. But it seems that there is some chatter there that that's going to pick up, probably early next year.

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

Sal Tharani - Goldman Sachs - Analyst

Thank you very much.

Operator

Michelle Applebaum, Steel Market Intelligence.

Michelle Applebaum - Steel Market Intelligence - Analyst

Did you mention what was going on with beam prices and imports?

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

No. But I will. Beam prices, they took the \$30 a ton discount, as most of the other products did, that was announced last week. Imports -- imports are not as bad. And when you hear about imports coming in from like the European group, there used to be maybe two stops at two different ports, the largest being Houston in the past. And now it seems like they're -- not seems like. Now they are hitting many other ports. So rather than dumping it at one port in particular, maybe 50% of a 30,000 ton load, they are hitting multiple ports and even going south of Houston and into the Mexico area. So there is not -- it's not a factor, it's not something that -- it hits us all little bit certainly when it lands, there's no getting around that. But I think from an overall standpoint when you look back at the whole big picture, it's really not that big of an issue at all.

Michelle Applebaum - Steel Market Intelligence - Analyst

Okay, thank you.

Operator

Bob Richard.

Bob Richard - Iron Edge Research - Analyst

Iron Edge Research. The restrictions on the revolver, I think if I heard right, through June of next year, June 30, are those material enough to discuss here?

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

We did file that, so the information is out there. But basically on the financial covenant ratios, we had our required debt to capital ratio reduced from 60% to 50%. And then our interest coverage ratio, which quite honestly is where we were feeling some pressure, we had a minimum requirement of three times. And that's now pushed down to two times. Both of those through June 30th of 2010, then they step back up to the previous amount.

Bob Richard - Iron Edge Research - Analyst

Thank you, that's helpful. I think if I remember right, your impairment testing for goodwill comes up here in a couple weeks.

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

It will be on November 1.

Oct. 22. 2009 / 11:00AM ET, RS - Q3 2009 Reliance Steel & Aluminum Co. Earnings Conference Call

Bob Richard - Iron Edge Research - Analyst

Any preview on that? Or just see how that goes, I guess?

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

We are not aware of any events that have caused impairment.

Bob Richard - Iron Edge Research - Analyst

Thanks very much.

Operator

There appear to be no further questions in queue.

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

How about that. Thanks. We'll just say goodbye, and thank you for your attention and your support, and I guess we won't be talking to you again until February, after the fourth quarter closes up and we have our final-year numbers.

It's a better environment out there now than it was when we were speaking to you 90 days ago. So we are encouraged. Once again, Reliance is on very solid footings, we are well-positioned; our management teams have done an outstanding job. And we are back into making money after one small little blip in the second quarter, but we are ready to go and looking forward to next year, really. So thank you very much.

Operator

Thank you ladies and gentlemen. This does conclude today's conference call. You may disconnect your phone lines at this time. And have a wonderful day. Thank you for your participation.

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