

RELIANCE STEEL & ALUMINUM CO

Form 10-Q

November 09, 2007

**Table of Contents**

**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2007**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number: 001-13122**

**RELIANCE STEEL & ALUMINUM CO.**

(Exact name of registrant as specified in its charter)

**California**

(State or other jurisdiction of  
incorporation or organization)

**95-1142616**

(I.R.S. Employer  
Identification No.)

**350 South Grand Avenue, Suite 5100**

**Los Angeles, California 90071**

**(213) 687-7700**

(Address of principal executive offices and telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No   
As of October 31, 2007, 74,830,074 shares of the registrant's common stock, no par value, were outstanding.

---

**RELIANCE STEEL & ALUMINUM CO.  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

<b>PART I FINANCIAL INFORMATION</b>	<b>1</b>
<b>Item 1.</b> <u>Consolidated Balance Sheets at September 30, 2007 (Unaudited) and December 31, 2006</u>	1
<u>Unaudited Consolidated Statements of Income for the Three-Month Periods Ended September 30, 2007 and 2006</u>	2
<u>Unaudited Consolidated Statements of Income for the Nine-Month Periods Ended September 30, 2007 and 2006</u>	3
<u>Unaudited Consolidated Statements of Cash Flows for the Nine-Month Periods Ended September 30, 2007 and 2006</u>	4
<u>Notes to Consolidated Financial Statements</u>	5
<b>Item 2.</b> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25
<b>Item 3.</b> <u>Quantitative and Qualitative Disclosures about Market Risk</u>	31
<b>Item 4.</b> <u>Controls and Procedures</u>	31
<b>PART II OTHER INFORMATION</b>	<b>32</b>
<b>Item 1A.</b> <u>Risk Factors</u>	32
<b>Item 6.</b> <u>Exhibits</u>	32
<b>SIGNATURES</b>	<b>33</b>
<b>CERTIFICATIONS</b>	<b>34</b>
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32</u>	

**Table of Contents****RELIANCE STEEL & ALUMINUM CO.  
CONSOLIDATED BALANCE SHEETS**

(In thousands, except share amounts)

**ASSETS**

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
	(Unaudited)	
Current assets:		
Cash and cash equivalents	\$ 106,003	\$ 57,475
Accounts receivable, less allowance for doubtful accounts of \$19,665 at September 30, 2007 and \$16,755 at December 31, 2006	807,798	666,273
Inventories	1,007,349	904,318
Prepaid expenses and other current assets	20,820	22,179
Income taxes receivable	14,696	25,144
Total current assets	1,956,666	1,675,389
Property, plant and equipment, at cost:		
Land	117,879	108,022
Buildings	415,263	385,851
Machinery and equipment	631,364	565,951
Accumulated depreciation	(368,533)	(317,152)
	795,973	742,672
Goodwill	937,446	784,871
Intangible assets, net	402,000	354,195
Cash surrender value of life insurance policies, net	43,861	41,190
Other assets	15,125	15,856
Total assets	\$ 4,151,071	\$ 3,614,173

**LIABILITIES AND SHAREHOLDERS EQUITY**

Current liabilities:		
Accounts payable	\$ 402,796	\$ 340,356
Accrued expenses	59,589	36,481
Accrued compensation and retirement costs	82,571	92,905
Accrued insurance costs	36,123	34,475
Deferred income taxes	23,721	23,706
Current maturities of long-term debt	33,684	22,257
Current maturities of capital lease obligations	634	559
Total current liabilities	639,118	550,739
Long-term debt	1,239,551	1,083,095
Capital lease obligations	4,657	4,956
Long-term retirement costs	55,854	46,111

Edgar Filing: RELIANCE STEEL & ALUMINUM CO - Form 10-Q

Deferred income taxes	186,369	181,628
Minority interest	1,529	1,246
Commitments and contingencies Shareholders' equity:		
Preferred stock, no par value:		
Authorized shares 5,000,000 None issued or outstanding		
Common stock, no par value:		
Authorized shares 100,000,000 Issued and outstanding shares 74,618,149 at September 30, 2007 and 75,702,046 at December 31, 2006, stated capital	638,420	701,690
Retained earnings	1,362,230	1,046,339
Accumulated other comprehensive income /(loss)	23,343	(1,631)
Total shareholders' equity	2,023,993	1,746,398
Total liabilities and shareholders' equity	\$ 4,151,071	\$ 3,614,173

*See accompanying notes to consolidated financial statements.*

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**UNAUDITED CONSOLIDATED STATEMENTS OF INCOME**  
(In thousands, except share and per share amounts)

	<b>Three Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
Net sales	\$ 1,812,092	\$ 1,626,208
Other income, net	2,063	1,987
	1,814,155	1,628,195
Costs and expenses:		
Cost of sales (exclusive of depreciation and amortization shown below)	1,372,128	1,194,139
Warehouse, delivery, selling, general and administrative	252,017	224,798
Depreciation and amortization	19,791	16,511
Interest	20,517	19,354
	1,664,453	1,454,802
Income from continuing operations before income taxes	149,702	173,393
Provision for income taxes	56,137	65,888
Net income	\$ 93,565	\$ 107,505
Earnings per share:		
Income from continuing operations diluted	\$ 1.22	\$ 1.41
Weighted average shares outstanding diluted	76,476,928	76,016,596
Income from continuing operations basic	\$ 1.24	\$ 1.42
Weighted average shares outstanding basic	75,609,783	75,451,585
Cash dividends per share	\$ .08	\$ .06

*See accompanying notes to consolidated financial statements.*

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**UNAUDITED CONSOLIDATED STATEMENTS OF INCOME**  
(In thousands, except share and per share amounts)

	<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
Net sales	\$ 5,550,018	\$ 4,173,416
Other income, net	4,770	3,641
	5,554,788	4,177,057
Costs and expenses:		
Cost of sales (exclusive of depreciation and amortization shown below)	4,140,105	3,051,289
Warehouse, delivery, selling, general and administrative	772,118	587,245
Depreciation and amortization	57,452	45,132
Interest	60,242	41,996
	5,029,917	3,725,662
Income from continuing operations before income taxes	524,871	451,395
Provision for income taxes	196,826	171,530
Net income	\$ 328,045	\$ 279,865
Earnings per share:		
Income from continuing operations diluted	\$ 4.28	\$ 3.83
Weighted average shares outstanding diluted	76,613,307	72,985,065
Income from continuing operations basic	\$ 4.32	\$ 3.87
Weighted average shares outstanding basic	75,896,299	72,315,779
Cash dividends per share	\$ .24	\$ .16

*See accompanying notes to consolidated financial statements.*

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Operating activities:</b>		
Net income	\$ 328,045	\$ 279,865
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	57,452	45,132
Debt premium amortization		(1,779)
Gain on sales of machinery and equipment	(1,115)	(990)
Deferred income taxes	(2,333)	(1,297)
Minority interest	283	227
Stock based compensation expense	7,569	4,336
Excess tax benefits from stock based compensation	(6,062)	(1,769)
Decrease in cash surrender value of life insurance policies	464	494
Changes in operating assets and liabilities (excluding effect of businesses acquired):		
Accounts receivable	(66,632)	(130,298)
Inventories	16,454	(172,732)
Prepaid expenses and other assets	15,586	9,593
Accounts payable and accrued expenses	34,976	(19,253)
Net cash provided by operating activities	384,687	11,529
<b>Investing activities:</b>		
Purchases of property, plant and equipment	(88,350)	(84,720)
Acquisitions of metals service centers and net asset purchases of metals service centers, net of cash acquired	(257,640)	(559,393)
Tax distributions made related to a prior acquisition	(634)	(894)
Proceeds from sales of property and equipment	2,833	2,956
Net proceeds from redemption of life insurance policies	134	489
Net investment in life insurance policies	(262)	(279)
Net cash used in investing activities	(343,919)	(641,841)
<b>Financing activities:</b>		
Proceeds from borrowings	648,554	993,316
Principal payments on long-term debt and short-term borrowings	(558,155)	(368,123)
Payments to former minority shareholders		(1,291)
Dividends paid	(18,216)	(11,608)
Excess tax benefits from stock based compensation	6,062	1,769
Exercise of stock options	11,047	2,852
Issuance of common stock	281	222
Common stock repurchase	(82,167)	



Edgar Filing: RELIANCE STEEL & ALUMINUM CO - Form 10-Q

Net cash provided by financing activities	7,406	617,137
Effect of exchange rate changes on cash	354	194
Increase /(decrease) in cash and cash equivalents	48,528	(12,981)
Cash and cash equivalents at beginning of period	57,475	35,022
Cash and cash equivalents at end of period	\$ 106,003	\$ 22,041

**Supplemental cash flow information:**

Interest paid during the period	\$ 45,395	\$ 24,997
Income taxes paid during the period	\$ 183,734	\$ 155,221

**Non-cash investing and financing activities:**

Issuance of common stock and stock options in connection with acquisition of metals service center	\$	\$ 360,453
Issuance of common stock to employee retirement savings plan	\$	\$ 2,830

*See accompanying notes to consolidated financial statements.*

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation with respect to the interim financial statements have been included. The results of operations for the three and nine months ended September 30, 2007 are not necessarily indicative of the results for the full year ending December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2006, included in Reliance Steel & Aluminum Co. 's Annual Report on Form 10-K.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts and the disclosure of contingent amounts in the Company 's consolidated financial statements and the accompanying notes. Actual results could differ from those estimates. Certain prior year amounts have been reclassified to conform to the current year presentation.

The Company 's consolidated financial statements include the assets, liabilities and operating results of majority-owned subsidiaries. The ownership of the other interest holders of consolidated subsidiaries is reflected as minority interest. All significant intercompany accounts and transactions have been eliminated.

**2. Impact of Recently Issued Accounting Principles**

In July 2006, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 48 ( FIN No. 48 ), *Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109*. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity 's financial statements in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 109, *Accounting for Income Taxes*. FIN No. 48 prescribes a recognition threshold and measurement principles for financial statement disclosure of tax positions taken or expected to be taken on a tax return. The Company adopted the provision of this interpretation effective January 1, 2007. The adoption of FIN No. 48 did not have a material impact on the Company 's consolidated financial position and results of operations. See Note 6, Income Taxes, for further discussion.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This Standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, which is the year beginning January 1, 2008 for the Company. The adoption of SFAS No. 157 is not expected to have a material impact on the Company 's financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, which is the year beginning January 1, 2008 for the Company. The Company is evaluating the impact that the adoption of SFAS No. 159 will have on its consolidated results of operations and financial condition.

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**3. Acquisitions**

***2007 Acquisitions***

*Acquisition of Clayton Metals, Inc.*

On July 1, 2007, the Company acquired all of the outstanding capital stock of Clayton Metals, Inc. ( Clayton Metals ), an Illinois corporation headquartered in Wood Dale, Illinois. Clayton Metals, founded in 1976, specializes primarily in the processing and distribution of aluminum, stainless steel and red metal flat-rolled products, custom extrusions and aluminum circles through its metals service center locations in Wood Dale, Illinois; Cerritos, California; High Point, North Carolina; and Parsippany, New Jersey. The Company acquired Clayton Metals through RSAC Management Corp., the Company's wholly-owned subsidiary.

*Acquisition of Encore Group*

As of February 1, 2007, the Company acquired the net assets and business of the Encore Group of metals service center companies (Encore Metals, Encore Metals (USA), Inc., Encore Coils, and Team Tube in Canada) headquartered in Edmonton, Alberta, Canada. Encore was organized in 2004 in connection with the buyout by management and a private equity fund managed by HSBC Capital (Canada) Inc. of certain former Corus CIC and Corus America businesses. Encore specializes in the processing and distribution of alloy and carbon bar and tube, as well as stainless steel sheet, plate and bar and carbon steel flat-rolled products, through its 17 facilities located mainly in Western Canada. The Company acquired the Encore Group assets through RSAC Canada Limited (now Encore Group Limited), the Company's wholly-owned Canadian subsidiary, and RSAC Canada (Tube) ULC (now Team Tube Canada ULC), a subsidiary of RSAC Canada Limited. Encore Metals (USA), Inc. now operates as a wholly-owned subsidiary of Reliance.

*Acquisition of Crest Steel Corporation*

On January 2, 2007, the Company purchased all of the outstanding capital stock of Crest Steel Corporation ( Crest ), a metals service center company headquartered in Carson, California with facilities in Riverside, California and Phoenix, Arizona. Crest now operates as a wholly-owned subsidiary of RSAC Management Corp. Crest was founded in 1963 and specializes in the processing and distribution of carbon steel products including flat-rolled, plate, bars and structurals.

*Acquisition of Industrial Metals and Surplus, Inc.*

Also, on January 2, 2007, the Company, through its wholly-owned subsidiary Siskin Steel & Supply Company, Inc., purchased the outstanding capital stock of Industrial Metals and Surplus, Inc. ( Industrial Metals ), a metals service center company headquartered in Atlanta, Georgia and a related company, Athens Steel, Inc., located in Athens, Georgia. Industrial Metals was founded in 1978 and specializes in the processing and distribution of carbon steel structurals, flat-rolled and ornamental iron products. Industrial Metals now operates as a wholly-owned subsidiary of Siskin. Athens Steel was merged into Industrial Metals and operates as a division of Industrial Metals.

The total cost of the acquisitions of Clayton Metals, Crest, Industrial Metals, and Encore Group of approximately \$257,640,000 was funded with borrowings on the Company's syndicated credit facility. Total debt assumed, net of cash, in connection with these acquisitions was approximately \$75,977,000. The consolidated financial statements reflect the allocations of each acquisition's purchase price, which is preliminary as of September 30, 2007 for Encore Group and Clayton Metals.

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**2006 Acquisitions***Acquisition of Yarde Metals, Inc.*

On August 1, 2006, the Company acquired 100% of the outstanding capital stock of Yarde Metals, Inc. ( Yarde Metals ), a metals service center company headquartered in Southington, Connecticut for approximately \$100,000,000 plus the assumption of approximately \$101,000,000 of Yarde Metals' outstanding debt, net of cash acquired. Yarde Metals was founded in 1976 and specializes in the processing and distribution of stainless steel and aluminum plate, rod and bar products. Yarde has additional metals service centers in Pelham, New Hampshire; East Hanover, New Jersey; Hauppauge, New York; High Point, North Carolina; Streetsboro, Ohio; and Limerick, Pennsylvania and a sales office in Ft. Lauderdale, Florida. Yarde Metals operates as a wholly-owned subsidiary of RSAC Management Corp. In August 2007 the Yarde Metals sellers were paid an additional amount related to the Company's election of Section 338(h)(10) treatment for income tax purposes, resulting in additional goodwill of \$634,000.

The allocation of the total purchase price of Yarde Metals to the fair values of the assets acquired and liabilities assumed is as follows:

	<b>(In thousands)</b>
Allocation of the total purchase price to the fair values of assets acquired and liabilities assumed:	
Cash	\$ 10,244
Accounts receivable	53,448
Inventory	79,987
Property, plant and equipment	18,062
Goodwill	47,657
Intangible assets subject to amortization	3,100
Intangible assets not subject to amortization	22,900
Other current and long-term assets	5,743
 Total assets acquired	 241,141
Current and long-term debt	(111,168)
Other current and long-term liabilities	(29,204)
 Total liabilities assumed	 (140,372)
 Net assets acquired/Purchase price	 \$ 100,769

The acquisition of Yarde Metals was funded with borrowings on the Company's syndicated credit facility and a short-term supplemental credit facility.

*Acquisition of Earle M. Jorgensen Company*

On April 3, 2006, the Company acquired Earle M. Jorgensen Company ( EMJ ). EMJ, headquartered in Lynwood, California, is one of the largest distributors of metal products in North America with 40 service and processing centers. EMJ's net sales for the nine months ended December 31, 2006 were \$1,450,000,000. The Company paid \$6.50 in cash and issued 0.1784 of a share of Reliance common stock for each outstanding share of EMJ common stock. The fraction of the share of Reliance common stock issued in exchange for each share of EMJ common stock as a result of the acquisition was determined by the average daily closing sale price for Reliance common stock reported on the New York Stock Exchange for the 20-day trading period ending with and including the second complete trading day prior to the date that the acquisition became effective ( Average Stock Price ). The Average Stock Price for that 20-day

period exceeded the upper limit of the 15% symmetrical collar established in the merger agreement. In accordance with this formula, Reliance issued 8,962,268 shares of its common stock in exchange for the 50,237,094 shares of outstanding EMJ common stock. The recorded value of the cash and stock consideration,

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

in accordance with purchase accounting rules, was \$13.64 per EMJ share, the stock portion of which was calculated using a Reliance per share price of \$40.00 which was the 3-day average closing price as of the date the Average Stock Price exceeded the upper limit of the collar. The purchase also included the assumption of approximately \$252,900,000 of EMJ outstanding debt, including \$250,000,000 of 9.75% senior secured notes and \$2,900,000 of other debt. In addition, the Company cashed out certain EMJ stock option holders for aggregate consideration of approximately \$29,456,000 and incurred direct acquisition costs of approximately \$12,882,000. The majority of the \$250,000,000 EMJ senior secured notes were subsequently redeemed in November 2006. The remaining principal balance of these notes outstanding at September 30, 2007 was \$250,000. See Note 6.

The Company assumed an EMJ stock option plan and converted the outstanding EMJ options to options to acquire 287,886 shares of Reliance common stock on the same terms and conditions as were applicable to such options under the EMJ plan, with adjusted exercise price and number of shares to reflect the difference in the value of the stock. The Company also assumed an obligation resulting from EMJ's settlement with the U.S. Department of Labor to contribute the equivalent of 258,006 shares of Reliance common stock to EMJ's Retirement Savings Plan. At September 30, 2007 the remaining obligation to contribute cash to a phantom stock plan supplementing the EMJ Retirement Savings Plan consisted of the cash equivalent of 160,655 shares of Reliance common stock. This obligation will be satisfied by future contributions as allowed under the Internal Revenue Code and ERISA requirements. EMJ now operates as a wholly-owned subsidiary of Reliance.

The total cost of the acquisition, including cash and stock consideration, direct acquisition costs and value of vested options assumed, and allocation of the total purchase price to the fair values of the assets acquired and liabilities assumed is as follows:

	<b>(In thousands)</b>
Cash consideration	\$ 326,546
Value of common stock and vested stock options	360,453
Cash out of certain EMJ stock options	29,456
Direct acquisition costs	12,882
 Total purchase price	 \$ 729,337
 Allocation of the total purchase price to the fair values of assets acquired and liabilities assumed:	
Cash	\$ 46,091
Accounts receivable	191,203
Inventory	344,446
Property, plant and equipment	185,366
Goodwill	351,480
Intangible assets subject to amortization	93,800
Intangible assets not subject to amortization	187,900
Other current and long-term assets	69,023
 Total assets acquired	 1,469,309
 Current and long-term debt	 (274,745)
Deferred income taxes	(157,938)
Other current and long-term liabilities	(307,289)

Total liabilities assumed	(739,972)
Net assets acquired/Purchase price	\$ 729,337

The cash portion of the acquisition was funded with borrowings on the Company's syndicated credit facility.

8

---

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

*Acquisition of Flat Rock Metal Processing L.L.C.*

In March 2006, Precision Strip, Inc., a wholly-owned subsidiary of the Company, acquired certain assets and business of Flat Rock Metal Processing L.L.C. ( Flat Rock ) based in Flat Rock, Michigan. Flat Rock was founded in 2001 and was a privately-held toll processing company with facilities in Perrysburg, Ohio; Eldridge, Iowa; and Portage, Indiana. The Flat Rock facilities in Perrysburg, Ohio and Eldridge, Iowa began operating as Precision Strip locations immediately after the acquisition date. The Portage, Indiana location became operational in September 2006. In July 2006, Precision Strip made a decision to close the Eldridge, Iowa facility and did so by the end of November 2006. Costs associated with the closure were minimal. Both Perrysburg, Ohio and Portage, Indiana locations process and deliver carbon steel, aluminum and stainless steel products on a toll basis, processing the metal for a fee, without taking ownership of the metal.

*Acquisition of Everest Metals (Suzhou) Co., Ltd.*

Also in March 2006, Reliance Pan Pacific Pte., Ltd. ( Reliance Pan Pacific ) completed its purchase of Everest Metals, a metals service center company based near Shanghai, People's Republic of China. Reliance Pan Pacific is a joint venture company formed in October 2005 that is 70% owned by Reliance and 30% owned by Manufacturing Network Pte. Ltd. ( Manufacturing Network ), a Singapore based company. Manufacturing Network sold its 100% interest in Everest Metals to Reliance Pan Pacific on March 1, 2006. Everest Metals was formed in 2001 and began processing and distributing primarily aluminum products to the electronics industry in 2002.

*Acquisition of the minority interest in American Steel, L.L.C.*

In January 2006, the Company purchased the remaining 49.5% of American Steel L.L.C., from American Industries, Inc., the holder of the minority interest. As a result, effective January 3, 2006 the Company includes 100% of American Steel's income in its financial results. American Steel operates as a wholly-owned subsidiary of Reliance.

*Purchase price allocations*

The acquisitions of all the companies have been accounted for under the purchase method of accounting and, accordingly, the purchase price has been allocated to the assets acquired and liabilities assumed based on the estimated fair values at the date of each acquisition. The Company utilized the services of a third-party valuation specialist to assist in identifying and determining the fair market values and economic lives of acquired tangible and intangible assets. The accompanying consolidated statements of income include the revenues and expenses of each acquisition since its respective acquisition date.



**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

*Pro forma financial information*

The following unaudited pro forma summary financial results present the consolidated results of operations as if our acquisitions of Clayton Metals, Crest, EMJ, Encore Group, Industrial Metals, and Yarde Metals had occurred at the beginning of each reporting period, after the effect of certain adjustments, including increased depreciation expense resulting from recording fixed assets at fair value, interest expense on the acquisition debt, amortization of certain identifiable intangible assets, debt premium amortization from recording the EMJ senior notes at fair value, and a provision for income taxes for the companies that were previously taxed as S-Corporations under Section 1361 of the Internal Revenue Code. The pro forma results have been presented for comparative purposes only and are not indicative of what would have occurred had these acquisitions been made as of January 1, 2007 or January 1, 2006, or of any potential results which may occur in the future. No pro forma results are required for the three month period ended September 30, 2007 as all acquisitions occurred prior to or effective July 1, 2007.

	<b>Three Months Ended September 30, 2006 (In thousands, except per share amounts)</b>	
Pro forma (unaudited):		
Net sales	\$ 1,813,136	
Net income	\$ 114,644	
Earnings per share    diluted	\$ 1.51	
Earnings per share    basic	\$ 1.52	
	<b>Nine Months Ended September 30, 2007 (In thousands, except per share amounts)</b>	<b>Nine Months Ended September 30, 2006 (In thousands, except per share amounts)</b>
Pro forma (unaudited):		
Net sales	\$ 5,632,042	\$ 5,366,187
Net income	\$ 331,516	\$ 320,530
Earnings per share    diluted	\$ 4.33	\$ 4.22
Earnings per share    basic	\$ 4.37	\$ 4.25

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**4. Goodwill**

The changes in the carrying amount of goodwill for the nine months ended September 30, 2007 are as follows:

	<b>(In thousands)</b>
Balance as of December 31, 2006	\$ 784,871
Acquisitions	136,544
Effect of foreign currency translation	16,031
Balance as of September 30, 2007	\$ 937,446

**5. Intangible Assets, net**

The following table summarizes the Company's intangible assets, net:

	<b>September 30, 2007</b>		<b>December 31, 2006</b>	
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>
	<b>(In thousands)</b>			
Intangible assets subject to amortization:				
Covenants not to compete	\$ 6,753	\$ (6,130)	\$ 6,353	\$ (6,005)
Loan fees	15,985	(6,410)	15,001	(5,237)
Customer list/relationships	132,500	(15,641)	107,200	(9,749)
Software - internal use	8,100	(1,215)	8,100	(607)
Other	691	(433)	421	(382)
	164,029	(29,829)	137,075	(21,980)
Intangible assets not subject to amortization:				
Trade names	267,800		239,100	
	\$ 431,829	\$ (29,829)	\$ 376,175	\$ (21,980)

The Company recognized amortization expense for intangible assets of approximately \$7,850,000 and \$4,703,000 for the nine months ended September 30, 2007 and 2006, respectively. Based on the current amount of intangibles subject to amortization, the estimated amortization expense for the remaining three months of 2007 and each of the succeeding five years is as follows:

	<b>(In thousands)</b>
2007	\$ 2,640
2008	10,565
2009	9,894
2010	9,821
2011	9,499



**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**6. Income Taxes**

On January 1, 2007, the Company adopted the provisions of FIN No. 48. As a result of the implementation of FIN No. 48, the Company recognized no material adjustment to the liability for unrecognized income tax benefits. At the adoption date of January 1, 2007, the Company had approximately \$5,030,000 of unrecognized tax benefits. At September 30, 2007, the Company had approximately \$4,820,000 of unrecognized tax benefits all of which would impact the effective tax rate if recognized.

Reliance and its subsidiaries file numerous consolidated and separate income tax returns in the United States federal jurisdiction and in many state and foreign jurisdictions. Except for various pre-acquisition periods of newly acquired subsidiaries, the Company is no longer subject to U.S. federal, state and local, or foreign income tax examinations for years before 2002.

The Internal Revenue Service ( IRS ) is currently examining the Company s 2002 through 2004 federal income tax returns. The IRS has issued significant proposed adjustments related to certain of the Company s inventory costing and LIFO methods. The IRS has also issued a proposed adjustment for a pre-acquisition refund claim filed by one of the Company s subsidiaries. The Company has not accepted any of the IRS proposed adjustments and is currently contesting them through the IRS administrative proceedings. The Company is also under audit by various state and foreign jurisdictions but does not anticipate any material adjustments from these examinations. Certain of the current proposed adjustments are merely a timing impact or relate to pre-acquisition contingencies and therefore would not have an effect on the Company s effective tax rate. The Company does not anticipate that the proposed IRS adjustments, when resolved, would result in a material charge to its results of operations or financial condition. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of January 1, 2007 and September 30, 2007, there were approximately \$770,000 and \$1,800,000, respectively, of accrued interest and penalties related to uncertain tax positions.

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**7. Long-Term Debt**

Long-term debt consists of the following:

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
	<b>(In thousands)</b>	
Revolving line of credit (\$1,100,000,000 limit) due November 9, 2011, interest at variable rates (based on LIBOR plus 0.55% or the bank's prime rate as of September 30, 2007 and December 31, 2006), weighted average rate of 6.18% and 5.93% at September 30, 2007 and December 31, 2006, respectively	\$ 390,000	\$ 203,000
Senior unsecured notes due January 2, 2009, weighted average fixed interest rate of 7.37% and 7.33% at September 30, 2007 and December 31, 2006, respectively	10,000	30,000
Senior unsecured notes due January 2, 2008, weighted average fixed interest rate of 7.08% at September 30, 2007 and December 31, 2006	30,000	30,000
Senior unsecured notes due from October 15, 2008 to October 15, 2010, weighted average fixed interest rate of 6.66% at September 30, 2007 and December 31, 2006	103,000	103,000
Senior unsecured notes due from July 1, 2011 to July 2, 2013, weighted average fixed interest rate of 5.14% at September 30, 2007 and December 31, 2006	135,000	135,000
Senior unsecured notes due November 15, 2016, fixed interest rate of 6.20%, comprised of \$350,000,000 of principal balance net of \$884,000 and \$957,000 of unamortized debt discount at September 30, 2007 and December 31, 2006, respectively	349,116	349,043
Senior unsecured notes due November 15, 2036, fixed interest rate of 6.85%, comprised of \$250,000,000 of principal balance net of \$1,372,000 and \$1,407,000 of unamortized debt discount at September 30, 2007 and December 31, 2006, respectively	248,629	248,593
Senior notes due June 1, 2012, fixed rate of 9.75%, comprised of \$250,000 of principal balance and \$16,000 and \$19,000 of unamortized debt premium at September 30, 2007 and December 31, 2006, respectively	266	269
Variable Rate Demand Industrial Development Revenue Bonds, Series 1989 A, due July 1, 2014, with interest payable quarterly; variable interest rate of 3.83% and 3.80% at September 30, 2007 and December 31, 2006, respectively	1,850	2,050
Variable Rate Demand Revenue Bonds, Series 1999, due March 1, 2009, with interest payable quarterly; variable interest rate of 4.04% and 4.11% at September 30, 2007 and December 31, 2006, respectively	900	1,225
Industrial Development Revenue Bonds, payable in annual installments of \$715,000 on December 1 <sup>st</sup> of each year, fixed interest rate of 5.25%	2,155	2,155
Revolving short-term \$4,000,000 credit facility for operations in China, weighted average interest rate of 6.09% and 6.00% (based on LIBOR plus 0.50%) at September 30, 2007 and December 31, 2006, respectively	2,319	1,017
<b>Total</b>	<b>1,273,235</b>	<b>1,105,352</b>

Edgar Filing: RELIANCE STEEL & ALUMINUM CO - Form 10-Q

Less amounts due within one year	(33,684)	(22,257)
Total long-term debt	\$ 1,239,551	\$ 1,083,095

On November 9, 2006, the Company amended and restated its syndicated credit agreement to allow for increased borrowings of up to \$1,100,000,000. This five-year, unsecured syndicated credit facility, which replaced the \$700,000,000 and \$100,000,000 existing bank credit lines, has fifteen banks as lenders and can be increased to \$1,600,000,000 with their approval.

The Company also has two separate revolving credit facilities for operations in Canada with a combined credit limit of CDN\$35,000,000. There were no borrowings outstanding on these credit facilities at September 30, 2007 and December 31, 2006.

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

At September 30, 2007, the Company had \$38,430,000 of letters of credit outstanding under the syndicated credit facility with availability to issue an additional \$86,570,000 of letters of credit. The syndicated credit facility includes a commitment fee on the unused portion, at an annual rate of 0.125% at September 30, 2007.

On November 20, 2006, the Company entered into an Indenture (the Indenture ), for the issuance of \$600,000,000 of unsecured debt securities which are guaranteed by all of the direct and indirect, wholly-owned domestic subsidiaries of the Company and any entities that become such subsidiaries during the term of the Indenture (collectively, the

Subsidiary Guarantors ). None of Reliance 's foreign subsidiaries or its non-wholly-owned domestic subsidiaries is a guarantor. The total debt issued was comprised of two tranches, (a) \$350,000,000 aggregate principal amount of senior unsecured notes bearing interest at the rate of 6.20% per annum, maturing on November 15, 2016 and (b) \$250,000,000 aggregate principal amount of senior unsecured notes bearing interest at the rate of 6.85% per annum, maturing on November 15, 2036. The notes are senior unsecured obligations of Reliance and rank equally with all other existing and future unsecured and unsubordinated debt obligations of Reliance. Reliance, at its option, may redeem all or part of the notes of either series at any time prior to their maturity by paying a redemption price equal to the greater of 100% of the aggregate principal amount of the notes to be redeemed or the sum of the present values of the remaining scheduled payments (as defined in the Indenture), plus, in each case, accrued and unpaid interest thereon to, but not including, the redemption date. The proceeds from the notes were used to pay down outstanding borrowings on the \$1,100,000,000 credit facility. In April 2007, these notes were exchanged for publicly traded notes registered with the Securities and Exchange Commission.

The Company also has \$278,000,000 of outstanding senior unsecured notes issued in private placements of debt. The outstanding senior notes bear interest at a weighted average fixed rate of 6.0% and have a weighted average remaining life of 3.4 years, maturing from 2008 to 2013.

The \$1,100,000,000 syndicated credit agreement and the senior unsecured note agreements require the Company to maintain a minimum net worth and interest coverage ratio and a maximum leverage ratio, and include a change of control provision, among other things.

**8. Shareholders Equity**

*Common Stock Split*

On May 17, 2006, Reliance 's Board of Directors declared a two-for-one stock split in the form of a 100% stock dividend on the Company 's common stock. The common stock split was effected by issuing one additional share of common stock for each share held by shareholders of record on July 5, 2006. The additional shares were distributed on July 19, 2006. All share and per share data, including prior period data as appropriate, have been adjusted to reflect this split.

*Common Stock*

Additionally, during the nine months ended September 30, 2007, the Company issued 583,326 shares of common stock in connection with the exercise of employee stock options for total proceeds of approximately \$11,047,000. Also, 6,244 shares of common stock valued at approximately \$280,000 were issued to division managers of the Company in March 2007 under the Key Man Incentive Plan for 2006.

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

*Share Repurchase Program*

The Stock Repurchase Plan ( Repurchase Plan ) was initially established in December 1994 and authorized the Company to purchase shares of its common stock from time to time in the open market or in privately negotiated transactions. In May 2005, the Board amended and restated the Repurchase Plan to authorize the purchase of up to an additional 12,000,000 shares of the Company's common stock and to extend the term of the Repurchase Plan for ten years, to December 31, 2014.

During the 2007 third quarter the Company repurchased 1,673,467 shares of its common stock at an average cost of \$49.10 per share. This was the first time that the Company has repurchased its stock since 2000. Since initiating the Stock Repurchase Plan in 1994, the Company has repurchased 12,750,017 shares at an average cost of \$12.93 per share. Repurchased shares are redeemed and treated as authorized but unissued shares. The Company currently has authorization to purchase an additional 10,326,533 shares under the Repurchase Plan.

*Other Comprehensive Income*

Statement of Financial Accounting Standards ( SFAS ) No. 130, *Reporting Comprehensive Income*, defines comprehensive income (loss) as non-stockholder changes in equity. Comprehensive income for each of the three- and nine-month periods ended September 30, 2007 and 2006, respectively, included the following:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>			
Net income	\$ 93,565	\$ 107,505	\$ 328,045	\$ 279,865
Other comprehensive income:				
Foreign currency translation gain	9,858	198	24,866	1,980
Minimum pension liability, net of tax				574
Unrealized gain on investments, net of tax	41	54	108	52
Total other comprehensive income	9,899	252	24,974	2,606
Total comprehensive income	\$ 103,464	\$ 107,757	\$ 353,019	\$ 282,471

Accumulated other comprehensive income included the following:

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
	<b>(In thousands)</b>	
Foreign currency translation adjustments	\$ 27,588	\$ 2,721
Unrealized gain on investments, net of tax	352	245
Minimum pension liability, net of tax	(4,597)	(4,597)
Total accumulated other comprehensive income	\$ 23,343	\$ (1,631)

Foreign currency translation adjustments are not generally adjusted for income taxes as they relate to indefinite investments in foreign subsidiaries. Unrealized gain on investments and minimum pension liability are net of taxes of (\$217,000) and \$2,836,000, respectively, as of September 30, 2007 and (\$151,000) and \$2,836,000, respectively, as of December 31, 2006.





**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**9. Employee Benefits***Defined Benefit and Supplemental Executive Retirement Plans*

The Company maintains a Supplemental Executive Retirement Plan ( SERP ), which is a nonqualified pension plan that provides post-retirement and certain pre-retirement pension benefits to key officers of the Company. Separate SERP plans exist for three of the Company's subsidiaries, each of which provides post-retirement benefits to certain key employees. Certain other deferred compensation arrangements exist for key officers or employees at some of our subsidiary companies.

The Company maintains, through various subsidiaries, defined benefit pension plans for certain of its employees. These plans generally provide benefits of stated amounts for each year of service or provide benefits based on the participant's hourly wage rate and years of service.

The net periodic pension costs for the SERP and defined benefit plans were as follows (in thousands):

<b>Three Months Ended September 30,</b>	<b>SERP Plans</b>		<b>Defined Benefit Plans</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Service Cost	\$ 241	\$ 142	\$ 206	\$ 158
Interest Cost	392	283	411	348
Expected return on assets			(467)	(390)
Amortization of prior service cost	49	49	5	(17)
Amortization of net loss/(gain)	313	119	4	(46)
Settlement expense				(6)
Net periodic pension cost	\$ 995	\$ 593	\$ 159	\$ 47

<b>Nine Months Ended September 30,</b>	<b>SERP Plans</b>		<b>Defined Benefit Plans</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Service Cost	\$ 722	\$ 425	\$ 618	\$ 525
Interest Cost	1,176	841	1,232	869
Expected return on assets			(1,402)	(905)
Amortization of prior service cost	147	147	15	19
Amortization of net loss	938	376	13	87
Settlement expense			15	823
Net periodic pension cost	\$ 2,983	\$ 1,789	\$ 491	\$ 1,418

*Post-retirement Plan*

In addition to the Company's defined benefit pension plans as noted above, EMJ sponsors a defined benefit health care plan that provides post-retirement medical and dental benefits to eligible full time employees and their dependents (the Post-retirement Plan). The Post-retirement Plan is fully insured, with retirees paying a percentage of the annual premium. Such premiums are adjusted annually based on age and length of service of active and retired participants. The Post-retirement Plan contains other cost-sharing features such as deductibles and coinsurance. The Company recognizes the cost of future benefits earned by participants during their working careers, as determined using actuarial assumptions. Gains and losses realized from the remeasurement of the plan's benefit obligation are amortized to income over three years.

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

Components of the net periodic pension expense associated with the Company's Post-retirement Plan are as follows (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Service Cost	\$ 123	\$ 100	\$ 368	\$ 200
Interest Cost	110	88	331	177
Amortization of net loss	21	(10)	64	10
Net periodic pension cost	\$ 254	\$ 178	\$ 763	\$ 387

*Contributions*

The Company previously disclosed in its financial statements for the year ended December 31, 2006, included in its Annual Report on Form 10-K, that it expected to contribute \$1,515,000 to its defined benefit plans in 2007. As of September 30, 2007, contributions of approximately \$2,841,000 had been made.

*Share Based Compensation*

On March 2, 2007, the Company granted 1,026,500 options to acquire its common stock to key employees with an exercise price equal to the fair market value. The stock options vest ratably over a period of four years and expire seven years after the date of grant. The fair value of stock options granted was estimated using the Black-Scholes option-pricing model with the following assumptions: Expected life 4.75 years; Volatility 39.6%; Dividend yield 0.7%; Risk-free interest rate 4.5%; Grant date option fair value \$17.11.

On May 16, 2007, the Company granted 42,000 options to acquire its common stock to the non-employee members of the Board of Directors with an exercise price equal to the fair market value. The stock options cliff vest after one year and expire ten years after the date of grant. The fair value of stock options granted was estimated using the Black-Scholes option-pricing model with the following assumptions: Expected life 5.5 years; Volatility 38.6%; Dividend yield 0.5%; Risk-free interest rate 4.6%; Grant date option fair value \$25.24.

*Supplemental Bonus Plan*

In 2005, prior to Reliance's acquisition, EMJ reached a settlement with the U.S. Department of Labor regarding a change in its methodology for annual valuations of its stock while it was a private company for the purpose of making contributions in stock to its retirement plan. This resulted in a special additional contribution to the plan in shares of EMJ common stock. During the nine months ended September 30, 2007, EMJ paid out cash of \$341,000 in lieu of 9,378 Reliance shares to terminated employees. At September 30, 2007, the remaining obligation to contribute cash to a phantom stock plan supplementing the EMJ Retirement Savings Plan consisted of the cash equivalent of 160,655 shares of Reliance common stock. This obligation will be satisfied by future cash contributions as allowed under the Internal Revenue Code and ERISA requirements.

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**10. Earnings Per Share**

The Company calculates basic and diluted earnings per share as required by SFAS No. 128, *Earnings Per Share*. Basic earnings per share exclude any dilutive effects of options, warrants and convertible securities. Diluted earnings per share are calculated including the dilutive effects of warrants, options, and convertible securities, if any. The following table sets forth the computation of basic and diluted earnings per share:

	<b>Three Months Ended September 30, 2007</b>		<b>Nine Months Ended September 30, 2007</b>	
	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2006</b>
	<b>(In thousands, except per share amounts)</b>			
Numerator:				
Net income	\$ 93,565	\$ 107,505	\$ 328,045	\$ 279,865
Denominator:				
Denominator for basic earnings per:				
Weighted average shares	75,610	75,452	75,896	72,316
Effect of dilutive securities:				
Stock options	867	565	717	669
Denominator for dilutive earnings per share:				
Adjusted weighted average shares and assumed conversions	76,477	76,017	76,613	72,985
Earnings per share from continuing operations diluted				
	\$ 1.22	\$ 1.41	\$ 4.28	\$ 3.83
Earnings per share from continuing operations basic				
	\$ 1.24	\$ 1.42	\$ 4.32	\$ 3.87

The computations of earnings per share for the three and nine months ended September 30, 2007 do not include 1,058,500 shares reserved for issuance upon exercise of stock options because their inclusion would have been anti-dilutive. The computations of earnings per share for the three and nine months ended September 30, 2006 do not include 278,288 and 42,000 shares reserved for issuance upon exercise of stock options, respectively, because their inclusion would have been anti-dilutive.

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**11. Condensed Consolidating Financial Statements**

In November 2006, the Company issued senior unsecured notes in the aggregate principal amount of \$600,000,000 at fixed interest rates that are guaranteed by its wholly-owned domestic subsidiaries. The accompanying combined and consolidating financial information has been prepared and presented pursuant to Rule 3-10 of SEC Regulation S-X

Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered. The guarantees are full and unconditional and joint and several obligations of each of the guarantor subsidiaries. There are no significant restrictions on the ability of the Company to obtain funds from any of the guarantor subsidiaries by dividends or loan. The supplemental consolidating financial information has been presented in lieu of separate financial statements of the guarantors as such separate financial statements are not considered meaningful. Certain prior year amounts have been adjusted to conform to current year presentation.

**Condensed Unaudited Consolidating Balance Sheet****As of September 30, 2007****(in thousands)**

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations &amp; Reclassifications</b>	<b>Consolidated</b>
<b>Assets</b>					
Cash and cash equivalents	\$ 2,898	\$ 90,197	\$ 12,908	\$	\$ 106,003
Accounts receivable, less allowance for doubtful accounts	90,879	661,989	54,930		807,798
Inventories	73,019	846,161	88,169		1,007,349
Intercompany receivables	630	4,025	755	(5,410)	
Prepaid expenses and other current assets	272	43,705	1,591	(10,052)	35,516
<b>Total current assets</b>	<b>167,698</b>	<b>1,646,077</b>	<b>158,353</b>	<b>(15,462)</b>	<b>1,956,666</b>
Investments in subsidiaries	2,797,573	40,083		(2,837,656)	
Property, plant and equipment, net	80,926	696,556	18,491		795,973
Goodwill	13,392	818,521	105,533		937,446
Intangible assets, net	6,009	395,978	13		402,000
Intercompany receivables		183,485		(183,485)	
Other assets	55	56,371	2,560		58,986
<b>Total assets</b>	<b>\$ 3,065,653</b>	<b>\$ 3,837,071</b>	<b>\$ 284,950</b>	<b>\$ (3,036,603)</b>	<b>\$ 4,151,071</b>
<b>Liabilities &amp; Shareholders Equity</b>					
Accounts payable	\$ 45,431	\$ 332,852	\$ 29,923	\$ (5,410)	\$ 402,796
Accrued compensation and retirement costs	4,799	72,709	5,063		82,571

Edgar Filing: RELIANCE STEEL & ALUMINUM CO - Form 10-Q

Other current liabilities	28,264	94,271	6,950	(10,052)	119,433
Current maturities of long-term debt	30,200	1,165	2,319		33,684
Current maturities of capital lease obligations		577	57		634
Total current liabilities	108,694	501,574	44,312	(15,462)	639,118
Long-term debt	847,394	392,157			1,239,551
Intercompany borrowings	124,507		58,978	(183,485)	
Deferred taxes and other long-term liabilities		245,665	2,744		248,409
Total shareholders equity	1,985,058	2,697,675	178,916	(2,837,656)	2,023,993
Total liabilities and shareholders equity	\$ 3,065,653	\$ 3,837,071	\$ 284,950	\$ (3,036,603)	\$ 4,151,071

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**Condensed Consolidating Balance Sheet**  
**As of December 31, 2006**  
**(in thousands)**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations & Reclassifications	Consolidated
<b>Assets</b>					
Cash and cash equivalents	\$ 2,556	\$ 45,189	\$ 9,730	\$	\$ 57,475
Accounts receivable, less allowance for doubtful accounts	87,570	545,931	32,585	187	666,273
Inventories	79,901	785,855	38,562		904,318
Intercompany receivables	655	2,781	338	(3,774)	
Prepaid expenses and other current assets		46,504	1,006	(187)	47,323
Total current assets	170,682	1,426,260	82,221	(3,774)	1,675,389
Investments in subsidiaries	2,308,683	31,021		(2,339,704)	
Property, plant and equipment, net	87,365	640,014	15,293		742,672
Goodwill	15,328	766,839	2,704		784,871
Intangible assets, net	5,591	348,581	23		354,195
Intercompany receivables	109,477			(109,477)	
Other assets	526	56,062	922	(464)	57,046
Total assets	\$ 2,697,652	\$ 3,268,777	\$ 101,163	\$ (2,453,419)	\$ 3,614,173
<b>Liabilities &amp; Shareholders Equity</b>					
Accounts payable	\$ 42,162	\$ 279,927	\$ 22,041	\$ (3,774)	\$ 340,356
Accrued compensation and retirement costs	10,199	78,960	3,746		92,905
Other current liabilities	7,598	84,292	2,772		94,662
Current maturities of long-term debt	20,200	1,040	1,017		22,257
Current maturities of capital lease obligations		559			559
Total current liabilities	80,159	444,778	29,576	(3,774)	550,739
Long-term debt	877,487	205,608			1,083,095
Intercompany borrowings		88,154	20,404	(108,558)	

Edgar Filing: RELIANCE STEEL & ALUMINUM CO - Form 10-Q

Deferred taxes and other long-term liabilities		232,330		1,611		233,941
Total shareholders equity	1,740,006	2,297,907		49,572	(2,341,087)	1,746,398
Total liabilities and shareholders equity	\$ 2,697,652	\$ 3,268,777	\$	101,163	\$ (2,453,419)	\$ 3,614,173



**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**Condensed Unaudited Consolidating Statement of Income**  
**For the three months ended September 30, 2007**  
(in thousands)

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$ 226,732	\$ 1,508,743	\$ 90,901	\$ (14,284)	\$ 1,812,092
Other income, net	31	18,910	2,479	(19,357)	2,063
	226,763	1,527,653	93,380	(33,641)	1,814,155
Costs and expenses:					
Cost of sales (exclusive of depreciation and amortization shown below)	171,057	1,145,668	69,708	(14,305)	1,372,128
Warehouse, delivery, selling, general and administrative	48,955	199,355	16,303	(12,596)	252,017
Depreciation and amortization	1,951	17,393	447		19,791
Interest	15,679	10,771	807	(6,740)	20,517
	237,642	1,373,187	87,265	(33,641)	1,664,453
Income (loss) before equity in earnings of subsidiaries and income taxes	(10,879)	154,466	6,115		149,702
Equity in earnings of subsidiaries	106,405	224		(106,629)	
Income from continuing operations before income taxes	95,526	154,690	6,115	(106,629)	149,702
Provision for income taxes	1,961	53,004	1,172		56,137
Net income	\$ 93,565	\$ 101,686	\$ 4,943	\$ (106,629)	\$ 93,565

**Condensed Unaudited Consolidating Statement of Income**  
**For the three months ended September 30, 2006**  
(in thousands)

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$ 225,595	\$ 1,352,067	\$ 58,178	\$ (9,632)	\$ 1,626,208
Other income, net	91	27,928	837	(26,869)	1,987
	225,686	1,379,995	59,015	(36,501)	1,628,195

Costs and expenses:					
Cost of sales (exclusive of depreciation and amortization shown below)	168,252	990,653	44,887	(9,653)	1,194,139
Warehouse, delivery, selling, general and administrative	57,171	179,896	10,981	(23,250)	224,798
Depreciation and amortization	1,891	14,338	282		16,511
Interest	6,221	16,582	149	(3,598)	19,354
	233,535	1,201,469	56,299	(36,501)	1,454,802
Income (loss) before equity in earnings of subsidiaries and income taxes					
	(7,849)	178,526	2,716		173,393
Equity in earnings of subsidiaries	122,404	1,146		(123,550)	
Income from continuing operations before income taxes					
	114,555	179,672	2,716	(123,550)	173,393
Provision for income taxes	7,050	57,990	848		65,888
Net income	\$ 107,505	\$ 121,682	\$ 1,868	\$ (123,550)	\$ 107,505

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**Condensed Unaudited Consolidating Statement of Income**  
**For the nine months ended September 30, 2007**  
(in thousands)

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$ 712,797	\$ 4,608,591	\$ 272,639	\$ (44,009)	\$ 5,550,018
Other income, net	261	77,325	5,207	(78,023)	4,770
	713,058	4,685,916	277,846	(122,032)	5,554,788
Costs and expenses:					
Cost of sales (exclusive of depreciation and amortization shown below)	533,479	3,443,238	207,459	(44,071)	4,140,105
Warehouse, delivery, selling, general and administrative	161,514	618,296	46,594	(54,286)	772,118
Depreciation and amortization	6,191	49,994	1,267		57,452
Interest	46,438	35,162	2,317	(23,675)	60,242
	747,622	4,146,690	257,637	(122,032)	5,029,917
Income (loss) before equity in earnings of subsidiaries and income taxes	(34,564)	539,226	20,209		524,871
Equity in earnings of subsidiaries	373,395	2,061		(375,456)	
Income from continuing operations before income taxes	338,831	541,287	20,209	(375,456)	524,871
Provision for income taxes	10,786	180,597	5,443		196,826
Net income	\$ 328,045	\$ 360,690	\$ 14,766	\$ (375,456)	\$ 328,045

**Condensed Unaudited Consolidating Statement of Income**  
**For the nine months ended September 30, 2006**  
(in thousands)

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$ 650,784	\$ 3,405,579	\$ 145,017	\$ (27,964)	\$ 4,173,416
Other income, net	833	74,723	1,265	(73,180)	3,641
	651,617	3,480,302	146,282	(101,144)	4,177,057

## Costs and expenses:

Cost of sales (exclusive of depreciation and amortization shown below)	475,363	2,493,574	110,378	(28,026)	3,051,289
Warehouse, delivery, selling, general and administrative	164,974	462,338	25,156	(65,223)	587,245
Depreciation and amortization	5,475	39,001	656		45,132
Interest	18,309	31,124	458	(7,895)	41,996
	664,121	3,026,037	136,648	(101,144)	3,725,662
Income (loss) before equity in earnings of subsidiaries and income taxes	(12,504)	454,265	9,634		451,395
Equity in earnings of subsidiaries	316,278	3,821		(320,099)	
Income from continuing operations before income taxes	303,774	458,086	9,634	(320,099)	451,395
Provision for income taxes	23,909	143,836	3,785		171,530
Net income	\$ 279,865	\$ 314,250	\$ 5,849	\$ (320,099)	\$ 279,865

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**Condensed Unaudited Consolidating Cash Flow Statement**  
**For the nine months ended September 30, 2007**  
**(in thousands)**

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Operating activities:</b>					
Net income	\$ 328,045	\$ 360,690	\$ 14,766	\$ (375,456)	\$ 328,045
Equity in earnings of subsidiaries	(373,395)	(2,061)		375,456	
Adjustments to reconcile net income to cash (used in) provided by operating activities	29,493	36,144	(8,995)		56,642
Cash (used in) provided by operating activities	(15,857)	394,773	5,771		384,687
<b>Investing activities:</b>					
Purchases of property, plant and equipment, net	(5,744)	(80,824)	(1,782)		(88,350)
Acquisitions of metals service centers and net asset purchases of metals service centers, net of cash acquired	(108,969)	(148,671)			(257,640)
Net advances from subsidiaries	233,984			(233,984)	
Other investing activities, net	121	1,866	84		2,071
Cash provided by (used in) investing activities	119,392	(227,629)	(1,698)	(233,984)	(343,919)
<b>Financing activities:</b>					
Net (repayments) borrowings of long-term debt	(20,200)	150,422	(39,823)		90,399
Dividends paid	(18,216)				(18,216)
Intercompany (repayments) borrowings		(272,558)	38,574	233,984	
Other financing activities	17,390				17,390
Common stock repurchase	(82,167)				(82,167)
Cash provided by (used in) financing activities	(103,193)	(122,136)	(1,249)	233,984	7,406
Effect of exchange rate changes on cash and cash equivalents			354		354
Increase in cash and cash equivalents	342	45,008	3,178		48,528

Cash and cash equivalents at beginning of period	2,556	45,189	9,730	57,475
Cash and cash equivalents at end of period	\$ 2,898	\$ 90,197	\$ 12,908	\$ 106,003

**Table of Contents**

**RELIANCE STEEL & ALUMINUM CO.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**Condensed Unaudited Consolidating Cash Flow Statement**  
**For the nine months ended September 30, 2006**  
**(in thousands)**

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Operating activities:</b>					
Net income	\$ 279,865	\$ 314,250	\$ 5,849	\$ (320,099)	\$ 279,865
Equity in earnings of subsidiaries	(316,278)	(3,821)		320,099	
Adjustments to reconcile net income to cash (used in) provided by operating activities	(40,205)	(237,147)	9,016		(268,336)
Cash (used in) provided by operating activities	(76,618)	73,282	14,865		11,529
<b>Investing activities:</b>					
Purchases of property, plant and equipment, net	(17,966)	(64,245)	(2,509)		(84,720)
Acquisitions of metals service centers and net asset purchases of metals service centers, net of cash acquired	(335,445)	(223,948)			(559,393)
Net advances from subsidiaries	463,948			(463,948)	
Other investing activities, net	814	1,390	68		2,272
Cash provided by (used in) investing activities	111,351	(286,803)	(2,441)	(463,948)	(641,841)
<b>Financing activities:</b>					
Net (repayments) borrowings of long-term debt	(25,200)	649,275	1,118		625,193
Dividends paid	(11,608)				(11,608)
Intercompany (repayments) borrowings		(454,789)	(9,159)	463,948	
Other financing activities	3,552				3,552
Cash (used in) provided by financing activities	(33,256)	194,486	(8,041)	463,948	617,137
Effect of exchange rate changes on cash and cash equivalents			194		194
Increase (decrease) in cash and cash equivalents	1,477	(19,035)	4,577		(12,981)
Cash and cash equivalents at beginning of period	1,256	26,549	7,217		35,022

Cash and cash equivalents at end of period	\$ 2,733	\$ 7,514	\$ 11,794	\$ 22,041
--	----------	----------	-----------	-----------

**12. Subsequent Event**

The Company acquired all of the outstanding capital stock of Metalweb plc ( Metalweb ), a metals service center company headquartered in Birmingham, England, effective October 1, 2007. Metalweb, established in 2001, specializes in the processing and distribution of primarily aluminum products for non-structural aerospace components and general engineering parts and has three additional service centers located in London, Manchester and Oxford, England. Metalweb plc's net sales for the fiscal year ended May 31, 2007 were approximately \$53,000,000. The all cash purchase price was funded with borrowings on the Company's syndicated credit facility.



**Table of Contents****RELIANCE STEEL & ALUMINUM CO.****Item 2. Management's Discussion And Analysis of Financial Condition And Results of Operations**

The following table sets forth certain income statement data for the three- and nine-month periods ended September 30, 2007 and 2006 (dollars are shown in thousands and certain amounts may not calculate due to rounding):

	Three Months Ended September 30,		2006		Nine Months Ended September 30,		2006	
	2007	% of		% of	2007	% of		% of
	\$	Net	\$	Net	\$	Net	\$	Net
		Sales		Sales		Sales		Sales
<b>Net sales</b>	\$ 1,812,092	100.0%	\$ 1,626,208	100.0%	\$ 5,550,018	100.0%	\$ 4,173,416	100.0%
<b>Gross profit</b>	439,964	24.3	432,069	26.6	1,409,913	25.4	1,122,127	26.9
<b>S,G&amp;A expenses</b>	252,017	13.9	224,798	13.8	772,118	13.9	587,245	14.1
<b>Depreciation expense</b>	17,004	0.9	14,793	0.9	49,602	0.9	40,429	1.0
<b>Operating profit<sup>(1)</sup></b>	\$ 170,943	9.4%	\$ 192,478	11.8%	\$ 588,193	10.6%	\$ 494,453	11.8%

(1) Excludes other income, amortization expense, interest expense, and income tax expense.

**2007 Acquisitions***Acquisition of Metalweb plc*

The Company acquired all of the outstanding capital stock of Metalweb plc ( Metalweb ), a metals service center company headquartered in Birmingham, England, effective October 1, 2007. Metalweb, established in 2001, specializes in the processing and distribution of primarily aluminum products for non-structural aerospace components and general engineering parts and has three additional service centers located in London, Manchester and Oxford, England. Metalweb plc's net sales for the fiscal year ended May 31, 2007 were approximately \$53 million.

*Acquisition of Clayton Metals, Inc.*

On July 1, 2007, the Company acquired all of the outstanding capital stock of Clayton Metals, Inc. ( Clayton Metals ), an Illinois corporation headquartered in Wood Dale, Illinois. Clayton Metals, founded in 1976, specializes primarily in the processing and distribution of aluminum, stainless steel and red metal flat-rolled products, custom extrusions and aluminum circles through its metals service center locations in Wood Dale, Illinois; Cerritos, California; High Point, North Carolina; and Parsippany, New Jersey. Clayton Metals' net sales for the twelve months ended December 31, 2006 were approximately \$123 million.

*Acquisition of Encore Group*

As of February 1, 2007, the Company acquired the net assets and business of the Encore Group of metals service center companies (Encore Metals, Encore Metals (USA), Inc., Encore Coils, and Team Tube in Canada) headquartered in Edmonton, Alberta, Canada. Encore was organized in 2004 in connection with the buyout by management and a private equity fund managed by HSBC Capital (Canada) Inc. of certain former Corus CIC and Corus America businesses. Encore specializes in the processing and distribution of alloy and carbon bar and tube, as well as stainless steel sheet, plate and bar and carbon steel flat-rolled products, through its 17 facilities located mainly in Western Canada. Encore Group's net sales for the year ended December 31, 2006 were approximately CDN\$259 million.

**Table of Contents**

*Acquisition of Crest Steel Corporation*

On January 2, 2007, the Company purchased all of the outstanding capital stock of Crest Steel Corporation ( Crest ), a metals service center company headquartered in Carson, California with facilities in Riverside, California and Phoenix, Arizona. Crest was founded in 1963 and specializes in the processing and distribution of carbon steel products including flat-rolled, plate, bars and structurals. Crest's net sales for the year ended December 31, 2006 were approximately \$133 million.

*Acquisition of Industrial Metals and Surplus, Inc.*

Also, on January 2, 2007, the Company's wholly-owned subsidiary, Siskin Steel & Supply Company, Inc., purchased the outstanding capital stock of Industrial Metals and Surplus, Inc. ( Industrial Metals ), a metals service center company headquartered in Atlanta, Georgia and a related company, Athens Steel, Inc., located in Athens, Georgia. Industrial Metals was founded in 1978 and specializes in the processing and distribution of carbon steel structurals, flat-rolled and ornamental iron products. Siskin's Georgia Steel Supply Company division located in Atlanta will be combined with the Industrial Metals operations. Net sales for Industrial Metals (including Athens Steel) for the year ended December 31, 2006 were approximately \$105 million.

The total cost of the acquisitions of Clayton Metals, Crest, Industrial Metals, and Encore Group of approximately \$257.6 million was funded with borrowings on the Company's syndicated credit facility. Total debt assumed, net of cash, in connection with these acquisitions was approximately \$76.0 million. The consolidated financial statements reflect the allocations of each acquisition's purchase price, which is preliminary as of September 30, 2007 for Encore Group and Clayton Metals.

**2006 Acquisitions**

*Acquisition of Yarde Metals, Inc.*

On August 1, 2006 we acquired Yarde Metals, Inc. ( Yarde Metals ), a metals service center company headquartered in Southington, Connecticut. We paid \$100 million in cash and assumed approximately \$101 million of net debt for all of the outstanding common stock of Yarde Metals. Yarde Metals was founded in 1976 and specializes in the processing and distribution of stainless steel and aluminum plate, rod and bar products. Yarde Metals has additional metals service centers in Pelham, New Hampshire; East Hanover, New Jersey; Hauppauge, New York; High Point, North Carolina; Streetsboro, Ohio; and Limerick, Pennsylvania and a sales office in Ft. Lauderdale, Florida. Yarde Metal's net sales for the five months ended December 31, 2006 were approximately \$182 million.

*Acquisition of Earle M. Jorgensen Company*

On April 3, 2006 we acquired Earle M. Jorgensen Company ( EMJ ), which was our first acquisition of a public company. EMJ, headquartered in Lynwood, California, is one of the largest distributors of metal products in North America with 40 service center facilities. The transaction was valued at approximately \$984 million, including the assumption of EMJ's net debt. We paid \$6.50 in cash and issued 0.1784 of a share of Reliance common stock for each share of EMJ common stock outstanding. This also was the first acquisition where we used our stock as consideration. EMJ's net sales for the nine months ended December 31, 2006 were approximately \$1.45 billion.

*Acquisition of Flat Rock Metal Processing L.L.C.*

On March 27, 2006, through Precision Strip, Inc. ( Precision Strip ), a wholly-owned subsidiary, we completed the acquisition of certain assets and business of Flat Rock Metal Processing, L.L.C. ( Flat Rock ). The Flat Rock toll processing business in Perrysburg, Ohio and Portage, Indiana are operated by Precision Strip.

**Table of Contents***Acquisition of Everest Metals (Suzhou) Co., Ltd.*

In October 2005, we formed Reliance Pan Pacific Pte., Ltd. ( RPP ) with our joint venture partner Manufacturing Network Pte. Ltd. ( MNPL ). We own 70% of RPP and MNPL owns the remaining 30%. On March 1, 2006, RPP acquired 100% of the outstanding equity interest in Everest Metals (Suzhou) Co., Ltd. ( Everest Metals ), a metals service center company near Shanghai, People's Republic of China, from MNPL. Everest Metals was formed in 2001 and began processing and distributing primarily aluminum products to the electronics industry in 2002. Everest's net sales for the ten months ended December 31, 2006 were approximately \$6 million.

*Acquisition of the minority interest in American Steel, L.L.C.*

In January 2006, we purchased the remaining 49.5% of American Steel, L.L.C. ( American Steel ), from American Industries, Inc., the holder of the minority interest. As a result, effective January 3, 2006, we include 100% of American Steel's income in our financial results.

**Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006**

In the three months ended September 30, 2007, our consolidated net sales increased 11.4% to \$1.81 billion, compared to \$1.63 billion for the three months ended September 30, 2006. This includes an 8.3% increase in our tons sold and a 3.3% increase in our average selling price per ton sold (the tons sold and average selling price per ton sold exclude the amounts related to Precision Strip, a toll processing business). Our 2006 and 2007 acquisitions were the primary factor in our increase in tons.

Same-store sales, which exclude the sales of our 2006 and 2007 acquisitions, were \$1.04 billion in the 2007 third quarter, down 0.6% from the 2006 third quarter, with a 2.2% decrease in our tons sold and a 2.0% increase in our average selling price per ton sold. The decrease in tons sold was due to a slight reduction in demand in many end markets that we serve compared to the 2006 third quarter when demand was very strong. Our average selling price per ton sold increased mainly because of cost increases for stainless products since the 2006 period.

Our 2007 third quarter gross profit was \$440.0 million compared to \$432.1 million in the 2006 third quarter. Our gross profit as a percentage of sales in the 2007 third quarter was 24.3% compared to 26.6% in the 2006 third quarter. Our gross profit margin was lower than the 2006 third quarter mainly because nickel surcharges on stainless products experienced significant decreases during the 2007 third quarter, lowering our stainless selling prices more rapidly than our inventory costs on hand were lowered, resulting in reduced margins.

In the 2007 third quarter, LIFO expense, which is included in cost of sales, was \$12.5 million, or \$.10 earnings per diluted share, mainly because of higher costs for stainless steel products in 2007. In the 2006 third quarter we recorded LIFO expense of \$33.3 million, or \$.27 earnings per diluted share.

Our 2007 third quarter warehouse, delivery, selling, general and administrative ( S,G,&A ) expenses were 13.9% as a percentage of sales, slightly up from 13.8% during the 2006 third quarter. Our increase in expense dollars of \$27.2 million was mainly due to our 2006 and 2007 acquisitions, along with general cost increases.

Depreciation expense in the 2007 third quarter was \$17.0 million compared to \$14.8 million in the 2006 third quarter. The increase was mostly due to the additional depreciation expense from our 2006 and 2007 acquisitions and depreciation on new assets placed in service during the last quarter of 2006 and throughout 2007.

Operating profit in the 2007 third quarter was \$170.9 million, or 9.4%, compared to \$192.5 million, or 11.8%, in the 2006 third quarter. Our operating profit margins have declined because of the lower gross profit margins experienced in 2007.

**Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006**

Our 2007 nine-month consolidated sales of \$5.55 billion were up 33.0% from the 2006 nine-month period. This includes a 19.5% increase in tons sold and a 12.1% increase in our average selling price per ton sold. Our 2006 and 2007 acquisitions contributed to our increased sales in the 2007 nine-month period. Our 2006 and 2007 acquisitions,

**Table of Contents**

especially EMJ, Yarde Metals and Encore, also contributed to the increase in our average selling price per ton sold as our product mix shifted to higher percentages of aluminum, alloy and stainless steel products. Same-store sales were \$3.25 billion in the 2007 nine-month period, up 4.9% from the 2006 nine-month period, with a 2.1% decrease in our tons sold and a 7.6% increase in our average selling price per ton sold. Increased stainless steel prices during the nine-month period, as compared to 2006, contributed to the increase in our average selling price per ton sold.

Total gross profit increased 25.6% to \$1.41 billion for the 2007 nine-month period compared to \$1.12 billion in the 2006 nine-month period. This increase is mainly due to the additional gross profit from our 2006 and 2007 acquisitions. Gross profit as a percentage of sales in the 2007 nine-month period was 25.4%, compared to 26.9% in the 2006 nine-month period. Our gross profit margins have been lower in 2007 as compared to 2006 mainly due to competitive pressures resulting from excess inventories throughout the industry and the adverse impact of the decline in nickel surcharges on stainless steel products during August and September 2007 that lowered our stainless selling prices more rapidly than our inventory costs on hand were lowered, resulting in reduced margins.

Also, in the 2007 nine-month period we recorded LIFO expense of \$45.0 million, or \$.37 earnings per diluted share, down from our 2006 nine-month LIFO expense of \$56.3 million, or \$.48 earnings per diluted share. The expense in 2007 is mainly due to increased costs for stainless steel products in 2007. Based on actual results to-date and our expectations for the remainder of 2007, we have lowered our annual LIFO expense estimate to \$60 million from \$65 million at the end of 2007. The reason for lowering our estimate is primarily due to the larger than anticipated stainless price decreases experienced in the third quarter, along with the unexpected decreases in common alloy aluminum pricing in the 2007 third quarter.

In the 2007 nine-month period our S,G&A expenses increased \$184.9 million or 31.5% compared to 2006, due mainly to the additional expenses of the companies that we acquired in 2006 and 2007. Our expenses as a percent of sales in the 2007 nine-month period were 13.9% compared to 14.1% in the 2006 period. The slight improvement as a percent of sales is mainly due to our increased selling prices in 2007 and our effective expense control.

Depreciation expense for the 2007 nine-month period was \$49.6 million compared to \$40.4 million in the 2006 nine-month period. The increase was mostly due to the additional depreciation expense from our 2006 and 2007 acquisitions, along with depreciation on new assets placed in service during the last quarter of 2006 and throughout 2007. Amortization expense increased \$3.1 million in the 2007 nine-month period primarily due to the additional amortization expense from our 2006 and 2007 acquisitions.

Our 2007 nine-month operating profit was \$588.2 million, resulting in an operating profit margin of 10.6%, compared to \$494.5 million, or an 11.8% operating profit margin in the same period of 2006. Our operating profit dollars increased because of our acquisitions. However, our operating profit margin declined mainly due to the somewhat lower gross profit margins in 2007, resulting primarily from the rapid reduction in stainless steel prices.

Interest expense for the 2007 nine-month period increased \$18.2 million or 43.4% due to additional borrowings made to fund our 2006 and 2007 acquisitions.

Our 2007 nine-month period effective income tax rate was 37.5% compared to 38.0% in the same nine-month period in 2006. The decrease in 2007 is mainly due to our increased international exposure and tax benefits from certain of our 2006 and 2007 acquisitions.

**Liquidity and Capital Resources**

At September 30, 2007, our working capital was \$1.32 billion, up from \$1.12 billion at December 31, 2006. The overall increase was primarily from the additional working capital of our 2007 acquisitions. Excluding the initial effect of acquisitions, working capital remained relatively unchanged with the increase in our accounts receivable of \$66.6 million offset by decreases in our inventories of \$16.5 million, prepaid expenses and other assets of \$15.6 million and accounts payable and accrued expenses of \$35.0 million.

To manage our working capital, we focus on our days sales outstanding to monitor accounts receivable and on our inventory turnover rate to monitor our inventory levels, as receivables and inventory are our two most significant elements of working capital. As of September 30, 2007, our days sales outstanding were approximately 40 days, a

**Table of Contents**

slight improvement from our 2006 year-end rate of 41 days. (We calculate our days sales outstanding as an average of the most recent two-month period.) Our inventory turn rate during the 2007 nine-month period was about 4.4 times (or 2.7 months on hand), consistent with our year end 2006 rate. Our 2006 and 2007 inventory turn rates were negatively impacted by our acquisitions of EMJ and Yarde Metals because they carry many products that do not typically turn at rates as high as many of our other products. We are focusing on improving our inventory turn rate from current levels. As demand and pricing for our products increase or decrease, our working capital needs increase or decrease, respectively. We expect to finance increases in our working capital needs through operating cash flow or with borrowings on our syndicated credit facility.

Our primary sources of liquidity are generally from internally generated funds from operations and our revolving line of credit. Cash flow provided by operations was \$384.7 million in the nine months ended September 30, 2007 compared to \$11.5 million in the nine months ended September 30, 2006. In the 2007 third quarter, we generated \$214.4 million of our cash flow from operations due to our focus on reducing inventory and our solid profit levels. In 2006 our working capital needs were increasing due to both increased demand and pricing. In 2007 our working capital needs have been more stable which contributed to our strong cash flows along with our increased earnings in the 2007 nine-month period.

Our outstanding debt (including capital lease obligations) at September 30, 2007 was \$1.28 billion, up from \$1.11 billion at December 31, 2006, mainly due to the financing of our 2007 acquisitions. At September 30, 2007, we had \$390 million borrowed on our \$1.1 billion revolving line of credit, which includes \$20 million to pay off private placement notes that matured in 2007. Our net debt-to-total capital ratio was 36.7% at September 30, 2007; slightly down from our 2006 year-end rate of 37.6% (net debt-to-total capital is calculated as total debt, net of cash, divided by shareholders' equity plus total debt, net of cash).

In the 2007 nine months we used our borrowings and cash flow to fund our increased working capital needs, capital expenditures of \$88.4 million and acquisitions of \$257.6 million. All of our 2007 acquisitions, Crest, IMS, Encore Group, Clayton Metals and Metalweb (completed on October 1, 2007) were funded by borrowings on our credit facility. Our September 30, 2007 financial statements include preliminary purchase price allocations for our 2007 acquisitions of Clayton Metals and Encore Group. In addition, we purchased \$82.2 million of our common stock in the 2007 third quarter. The significant cash flows from operations generated in the 2007 nine-month period allowed us to repay the borrowings made to fund the acquisitions of Clayton Metals and Metalweb and to finance our stock repurchases and capital expenditures.

At September 30, 2007, we also had \$278 million of outstanding senior unsecured notes issued in private placements of debt and \$600 million of publicly-traded outstanding senior unsecured notes. The \$278 million of outstanding private placement notes bear interest at a weighted average fixed rate of 6.0% and have a weighted average remaining life of 3.4 years, maturing from 2008 to 2013. The \$600 million unsecured debt securities are comprised of two tranches, (a) \$350 million aggregate principal amount of senior unsecured notes bearing interest at the rate of 6.20% per annum, maturing on November 15, 2016 and (b) \$250 million aggregate principal amount of senior unsecured notes bearing interest at the rate of 6.85% per annum, maturing on November 15, 2036. In April 2007, the \$600 million unsecured notes were exchanged for publicly traded notes registered with the Securities and Exchange Commission.

We also have two separate revolving credit facilities for operations in Canada with a combined credit limit of CDN\$35 million. There were no borrowings outstanding on these credit facilities at September 30, 2007 and December 31, 2006.

Our \$1.1 billion syndicated credit facility and our senior unsecured notes require that we maintain a minimum net worth and interest coverage ratio, and a maximum leverage ratio and include change of control provisions, among other things.

Proceeds from the issuance of common stock upon the exercise of stock options during the 2007 nine-month period were \$11.0 million.

**Table of Contents**

Capital expenditures were \$88.4 million for the nine months ended September 30, 2007 compared to \$84.7 million during the same prior year period. Our 2007 capital expenditure budget is approximately \$145 million. Our 2007 budget includes several growth initiatives to expand or relocate existing facilities and to add or upgrade equipment. We had no material changes in commitments for capital expenditures, operating lease obligations or purchase obligations as of September 30, 2007, as compared to those disclosed in our table of contractual obligations included in our Annual Report on Form 10-K for the year ended December 31, 2006, except the 2007 acquisitions discussed above. We anticipate that funds generated from operations and funds available under our \$1.1 billion credit facility will be sufficient to meet our working capital, capital expenditure and senior debt repayment needs in the near term. We also anticipate that we will be able to fund acquisitions with borrowings under our line of credit. Our credit facility can be increased from \$1.1 billion to \$1.6 billion upon approval of the lenders.

On May 17, 2006 our Board of Directors declared a two-for-one stock split, in the form of a 100% stock dividend on our common stock. The common stock split was effected by issuing one additional share of common stock for each share held by shareholders of record on July 5, 2006. The additional shares were distributed on July 19, 2006. On February 14, 2007, our Board of Directors declared a 33% increase in the regular quarterly cash dividend to \$.08 per share of common stock.

In May 2005, our Board of Directors amended and restated our stock repurchase program authorizing the repurchase of up to an additional 12.0 million shares of our common stock. Repurchased shares are treated as authorized but unissued shares. We repurchased approximately 1.7 million shares of our common stock during the 2007 third quarter, at an average cost of \$49.10 per share. This was the first time that we have repurchased our stock since 2000. Since initiating our Stock Repurchase Plan in 1994, we have repurchased approximately 12.8 million shares at an average cost of \$12.93 per share. We currently have authorization to purchase approximately an additional 10.3 million shares under our plan. We believe such purchases, given appropriate circumstances, enhance shareholder value and reflect our confidence in the long-term growth potential of our Company.

**Inflation**

Our operations have not been, and we do not expect them to be, materially affected by general inflation. Historically, we have been successful in adjusting prices to our customers to reflect changes in metal prices.

**Seasonality**

Some of our customers may be in seasonal businesses, especially customers in the construction industry. As a result of our geographic, product and customer diversity, however, our operations have not shown any material seasonal trends except that revenues in the months of July, November and December traditionally have been lower than in other months because of a reduced number of working days for shipments of our products, resulting from vacation and holiday closures at some of our customers. We cannot assure you that period-to-period fluctuations will not occur in the future. Results of any one or more quarters are therefore not necessarily indicative of annual results.

**Goodwill**

Goodwill, which represents the excess of cost over the fair value of net assets acquired, amounted to \$937.4 million at September 30, 2007, or approximately 22.6% of total assets, or 46.3% of consolidated shareholders' equity. Pursuant to SFAS No. 142, we review the recoverability of goodwill annually or whenever significant events or changes occur which might impair the recovery of recorded costs. Our annual impairment tests of goodwill were performed as of November 1, 2006 and it was determined that the recorded amounts for goodwill are recoverable and that no impairment existed. We are not aware of any significant events or changes that would affect the recoverability of those amounts as of September 30, 2007.

**Table of Contents**

**Critical Accounting Policies**

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our unaudited Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. When we prepare these financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to accounts receivable, inventories, deferred tax assets, goodwill and intangible assets and long-lived assets. We base our estimates and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

For further information regarding the accounting policies that we believe to be critical accounting policies and that affect our more significant judgments and estimates used in preparing our consolidated financial statements see our December 31, 2006 Annual Report on Form 10-K. We do not believe that any of our acquisitions completed during 2007 or new accounting standards implemented during 2007 changed our critical accounting policies.

**New Accounting Pronouncements**

See Notes to Consolidated Financial Statements for disclosure on new accounting pronouncements.

**Item 3. Quantitative And Qualitative Disclosures About Market Risk**

In the ordinary course of business, we are exposed to various market risk factors, including fluctuations in interest rates, changes in general economic conditions, domestic and foreign competition, foreign currency exchange rates, and metals pricing and availability. Please refer to Item 7A Quantitative and Qualitative Disclosures About Market Risk, contained in the Company's December 31, 2006 Annual Report on Form 10-K for further discussion on quantitative and qualitative disclosures about market risk.

**Item 4. Controls And Procedures**

Under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to and as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Act of 1934, as amended. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that, as of the end of the period covered in this report, the Company's disclosure controls and procedures are effective. There have been no changes in the Company's internal control over financial reporting during the quarter ended September 30, 2007, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

*This Form 10-Q may contain forward-looking statements relating to future financial results. Actual results may differ materially as a result of factors over which Reliance Steel & Aluminum Co. 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, 2006.*



**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1A. Risk Factors**

There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006.

**Item 6. Exhibits**

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
- 32 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**Table of Contents**

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

RELIANCE STEEL & ALUMINUM CO.

Dated: November 9, 2007

By: /s/ David H. Hannah  
David H. Hannah  
Chief Executive Officer

By: /s/ Karla Lewis  
Karla Lewis  
Executive Vice President and Chief  
Financial Officer

33