

METALS USA INC
Form 8-K
November 10, 2005

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 8-K

CURRENT REPORT

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

Date of Report (Date of Earliest Event Reported): November 10, 2005

METALS USA, INC.

(Exact Name of Registrant as Specified in Charter)

Delaware
(State or Other Jurisdiction of
Incorporation)

1-13123
(Commission File Number)

76-0533626
(IRS Employer Identification No.)

One Riverway, Suite 1100
Houston, Texas
(Address of Principal Executive Offices)

77056
(Zip Code)

Registrant's telephone number, including area code: **(713) 965-0990**

N/A

(Former Name or Former Address, if Changed Since Last Report)

Edgar Filing: METALS USA INC - Form 8-K

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

- o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

 - o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

 - o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 14d-2(b))

 - o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
-

Item 7.01 Regulation FD Disclosure

This current report on Form 8-K contains forward-looking statements within the meaning of the federal securities laws, which involve risks and uncertainties. You can identify forward-looking statements because they contain words such as believes, expects, may, should, seeks, approximately, intends, plans, estimates, or anticipates or similar expressions that relate to our strategy, plans or intentions. All statements we make relating to the closing of the merger described in this current report or to our estimated and projected earnings, margins, costs, expenditures, cash flows, growth rates and financial results or to our expectations regarding future industry trends are forward-looking statements. In addition, we, through our senior management, from time to time make forward-looking public statements concerning our expected future operations and performance and other developments. These forward-looking statements are subject to risks and uncertainties that may change at any time, and, therefore, our actual results may differ materially from those that we expected. We derive many of our forward-looking statements from our operating budgets and forecasts, which are based upon many detailed assumptions. While we believe that our assumptions are reasonable, we caution that it is very difficult to predict the impact of known factors, and, of course, it is impossible for us to anticipate all factors that could affect our actual results. All forward-looking statements are based upon information available to us on the date of this current report.

Important factors that could cause actual results to differ materially from our expectations (cautionary statements) are disclosed under Risk Factors. All forward-looking information in this current report and subsequent written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by the cautionary statements. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law.

As provided in General Instruction B.2 of Form 8-K, the information in this Form 8-K shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, nor shall it be deemed to be incorporated by reference in any filing under the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such a filing. Furnishing this information, we make no admission as to the materiality of any information in this report that is required to be disclosed solely by reason of Regulation FD.

The Company is hereby furnishing the following information regarding its business:

Our Company

Overview

As one of the largest metal service center businesses in the United States, we are a leading provider and distributor of value-added processed carbon steel, stainless steel, aluminum, red metals and manufactured metal components. We are an important intermediary between primary metal producers that produce and sell large volumes of metals in a limited number of sizes and configurations and end-users, such as contractors and OEMs that require smaller quantities of more customized products delivered on a just-in-time basis. We earn a margin over the cost of metal based upon value-added processing enhancements, which adds stability to our financial results and significantly reduces our earnings volatility relative to metal producers. In addition to our metal service center and distribution activities, we have a growing building products business, which supplies a range of products to the residential remodeling market. We serve more than 30,000 customers annually from 77 operating locations throughout the United States. For the LTM Period, we generated net sales of \$1,644.9 million, Adjusted EBITDA (as defined) of \$117.4 million and operating income of \$110.6 million.

Edgar Filing: METALS USA INC - Form 8-K

We have three segments, which are identified by their product groups the Plates and Shapes, Flat Rolled and Building Products Groups. Each of our segments purchases metal from primary producers who generally focus on large volume sales of unprocessed metals in standard configurations and sizes.

Our Plates and Shapes and Flat Rolled Groups perform customized, value-added processing services to unimproved steel and other metals required to meet specifications provided by our customers, as well as offering inventory management and just-in-time delivery services. These services enable our customers to reduce material costs, decrease capital required for raw materials inventory and processing equipment and save time, labor, warehouse space and other expenses. The customers of our Plates and Shapes and Flat Rolled Groups are in businesses such as the machining, furniture, transportation equipment, power and process equipment, industrial/commercial construction/fabrication, consumer durables and electrical equipment industries, as well as machinery and equipment manufacturers. Our Building Products Group manufactures higher-value finished building products for distributors and contractors engaged in residential and commercial building products.

Competitive Strengths

Margin Over Metal Creates Financial Stability. Our metal service centers are an integral intermediary between large metal producers and smaller end-users, which allows us to utilize a cost plus business model. Through our cost plus business model, we earn a margin over the cost of metal which varies according to the extent of value-added processing enhancements we add to our products. As a result, over time, we are able to pass along changes in metal prices to our customers. Given that metal costs typically represent approximately 75% of our net sales, our ability to pass through changes in pricing and our cost plus business model significantly reduce the volatility of our earnings and free cash flow relative to metal producers.

Skilled Inventory Management. We manage our inventory to minimize our investment in working capital while maintaining sufficient stock to respond quickly to customer orders. We tailor our inventory and processing services at each service center location to the needs of that particular market with branch management teams responsible for determining the inventory mix at each of our locations. All of our groups utilize management information systems and computer-aided manufacturing technology, which enable us to track and allocate inventory among all of our locations on a real-time basis, providing our salespeople and operating employees with visibility into in-process orders and allowing us to provide just-in-time delivery. We believe that the combination of our decentralized inventory management and the monitoring by our senior management with their global market insights has allowed us to react more quickly than many of our competitors to changing metals prices and customer needs, and to optimize our use of working capital. Also, due to the countercyclical nature of cash flows in our business, by proactively managing inventory we are able to generate significant earnings during rising metal price environments and generate significant free cash flow for debt paydown in declining metal price environments. For example, from December 31, 2004 to September 30, 2005, we reduced our inventory levels from approximately 300,299 tons to approximately 245,760 tons in the Plates and Shapes Group and from approximately 220,457 tons to approximately 125,880 tons in the Flat Rolled Group. Such inventory reductions allowed us to pay down a total of approximately \$146 million of debt in the second and third quarters of 2005.

Strong Relationships with Key Suppliers. In the metal service center industry, where buying right is critical to a company's success, we have established strong relationships with large domestic and international metal suppliers. We are a significant customer of our major suppliers in each of our core products, enabling us to obtain volume discounts and source materials in periods of tight supply. For instance, our strong relationships and large purchasing volumes enabled us to maintain ample access to metal when supply became constrained during 2004. Our negotiation of purchase agreements with suppliers is centralized to leverage our buying power and global market insights.

Geographically Diversified Network of Strategically Located Facilities. Our 77 operating facilities are strategically located throughout the United States, providing a number of advantages over smaller, locally-focused service centers. The majority of our service centers are located within 150-250 miles of our customers, which enables us to deliver products within one day of receiving an order. The proximity of our facilities to our customers allows us to provide critical, value-added services such as just-in-time delivery to both larger national customers with multiple locations and smaller single-site customers. Our service centers also have the ability to share inventory between facilities, which improves inventory management and customer service. The geographically diverse network of facilities provides

protection against regional fluctuations in demand and prices as we are not dependent on one geographical region or customer.

Broad Product Offering with Superior Customer Service. We provide a broad range of high quality products which, together with customized valued-added services, enable us to offer one-stop shopping to our customers. We believe that our broad product offering and value-added services provide a significant competitive advantage over smaller service centers that generally stock fewer products than we do. As a result of the regular interaction between our large field sales force and our customers, we have developed strong relationships with our customers, which allows us to identify and assess their supply chain requirements in a more accurate and timely manner. This ability in turn enables us to offer just-in-time delivery and to respond to short lead time orders. Further, because our local managers have significant operational control, our service centers can react quickly to changes in local markets and customer demands. We believe the quality of our products and timeliness of service have increased the loyalty of our customers and have assisted our marketing efforts to new customers.

Diversified Customer Base and End-Markets. Our three groups supply a broad range of products to a large diversified customer base which serves a diverse set of end-markets. We serve more than 30,000 customers annually across a broad range of industries including machining, furniture, transportation equipment, power and process equipment, industrial/commercial construction/fabrication, consumer durables, electrical equipment industries and machinery and equipment manufacturers. The automotive sector, in which we sell only to Tier 1 and Tier 2 suppliers, represented less than 4% of our sales in 2004. No single customer accounted for more than 2% of our net sales in 2004, while our ten largest customers represented less than 11% of our net sales in 2004. Further, the breakdown of our 2004 net sales by industry is:

State-of-the-Art Processing Facilities. Our state-of-the-art processing facilities provide a significant advantage over smaller metal service centers that do not have the necessary capital resources to invest in such equipment, thereby limiting the range of products they offer. We recently increased our laser cutting, painting and other value-added capabilities at select locations. As a result, our facilities are capable of quickly and efficiently processing metals to precise length, width, shape and surface quality required to satisfy individual customer specifications. In addition, we provide value-added services such as applications engineering and custom machining, in order to enable our customers to reduce their total cost of manufacturing.

Experienced and Proven Management Team. Our senior management team has an average of over 20 years of experience in the metals industry, and as such has a deep understanding of the dynamics between the various levels of the supply chain. Our CEO, Lourenço Gonçalves, who was appointed in February 2003, was previously CEO of California Steel Industries, the largest U.S. steel slab re-roller, which had many of the same value chain dynamics as a service center. Since he joined us, we have implemented a number of operational improvements that have significantly improved the performance of our business.

Strategy

Increase Our Market Share of Higher Margin Products. Our management team intends to continue its focus on selling higher margin products such as non-ferrous metals as well as those products that require significant value-added processing or which are highly customized. This focus will enable us to further leverage our state-of-the-art processing facilities and provide higher margin value-added processing functions such as precision blanking, laser cutting and painting. We believe that our ability to perform these types of processing functions will also enable us to fulfill a greater proportion of our customers' processing requirements, providing them with a more complete product and allowing them to achieve their objective of outsourcing a greater proportion of their processing requirements. We further believe that our ability to perform these types of processing functions will lead to an increased stability in the demand

for our products.

Expand Value-Added Services Provided to Customers. We are focused on expanding the range of value-added services that we offer to enhance our strong, long-standing relationships with our existing customers and to build new customer relationships. Our customers are continually seeking new ways to operate more efficiently and generate higher returns, including the outsourcing of customized metals processing and inventory management requirements. We believe our ability to provide value-added services, such as new supply chain solutions, is attractive to customers. We also believe that there are significant opportunities to expand the range of value-added services that we offer in areas such as processing equipment, inventory management and logistics systems. We believe that our size and operating expertise enable us to better provide these value-added services and therefore, further differentiate ourselves from smaller metal service centers.

Maintain Strong Focus on Inventory Management. We will continue managing our inventory to maximize our profitability and cash flow while maintaining sufficient stock to respond quickly to customer orders. We intend to continue to manage our inventory through a combination of local management of inventory requirements at each service center location and the centralized monitoring of inventory by our senior management team to leverage our buying power and global market insights. In addition, we intend to further integrate our salespeople and operating employees into the operations of our customers to enhance our visibility into in-process orders and to allow us to continue to improve our just-in-time delivery and overall level of customer service. We expect our continued focus on inventory management to improve gross profit margins

as well as further differentiate us from our smaller competitors. We believe it will also improve performance throughout the metal price cycle by ensuring that we will have ample supply to satisfy customer demand in rising price and constrained supply environments as well as enabling us to generate significant free cash flow in declining metal price environments.

Capitalize on Changing Market Dynamics and Increasing Demands. While steel producers have undergone significant consolidation, end-customer segments of the market remain highly fragmented. Therefore, while steel producers continue to seek select, long-term relationships with metal service centers that have access to numerous end-user customers, end-user customers are also seeking relationships with metal service centers that can provide a reliable source of high quality products combined with value-added services. As one of the largest metal service centers, we intend to use our significant resources to exploit the opportunities presented by this market dynamic. In addition, we believe that, in light of current economic conditions, demand for the products manufactured by our customers will continue to be robust. This increase in end-market demand will help drive increased sales of our products and, combined with the initiatives we have proactively taken to reduce our cost structure, further enhance our profitability and cash flow.

Continue to Focus on Improving the Performance of Our Building Products Group. In August 2004, we appointed a new President of the Building Products Group and subsequently undertook a major restructuring of the business to focus the group on the steadily growing residential remodeling market. In addition, we closed 11 underperforming sales locations, expanded our production capabilities and reduced the operating cost structure of the group. Since this time, the financial performance of the group has improved significantly and we expect it to become an increasingly larger part of our business in the future as we continue to capitalize on the benefits resulting from the restructuring and take advantage of the attractive fundamentals of the residential remodeling industry.

Segment Information

Each of our product groups is led by an experienced executive and is supported by a professional staff in finance, purchasing and sales and marketing. This product-oriented organizational structure facilitates the efficient advancement of our goals and objectives to achieve operational synergies and focused capital investment. For additional industry segment information, see the Segment Results discussions in Management's Discussion and Analysis of Financial Condition and Results of Operations.

Metal Processing/Service Center Businesses: Plates and Shapes and Flat Rolled Groups

Business Overview. Companies operating in the metals industry can generally be characterized as primary metals producers, metals processors/service centers or end-users. Our Plates and Shapes and Flat Rolled Groups are metals processor/service centers. As such, we purchase steel, aluminum, brass, copper and other metals from producing mills and then sell our metal processing services and the metal to our customers, who are generally end-users. We believe that both primary metals producers and end-users are increasingly seeking to have their metals processing and inventory management requirements met by value-added metals processors/service centers like us.

Primary metals producers, which manufacture and sell large volumes of metals in standard sizes and configurations, generally sell only to those large end-users and metals processors/service centers who do not require processing of the products and who can tolerate relatively long lead times. Metal processors/service centers offer services ranging from precision value-added pre-production processing, in accordance with specific customer specifications, to storage and distribution of unprocessed metal products. Generally service centers function as intermediaries between end-users and primary metals producers. End-users, such as contractors and OEMs incorporate the processed metal into a finished product, in some cases with little further modification.

In our Plates and Shapes and Flat Rolled Groups, we engage in pre-production processing of steel, stainless steel, red metals and aluminum and act as an intermediary between primary metals producers and end-users. We purchase metals from primary producers, maintain an inventory of various metals to allow rapid fulfillment of customer orders and perform customized processing services to the specifications provided by end-users and other customers. By providing these services, as well as offering inventory management and just-in-time delivery services, we enable our customers to reduce overall production costs and decrease capital required for raw materials inventory and metals processing equipment. The Plates and Shapes and Flat Rolled Groups contributed approximately 88% of our 2004 net sales and the substantial majority of our 2004 net income.

Industry Overview. Metal service centers function as key intermediaries between the primary metals producers that produce and sell large volumes of metals in a limited number of sizes and configurations and end-users, such as contractors and OEMs, that require smaller quantities of more customized products delivered on a just-in-time basis. End-users incorporate processed metals into finished products, in some cases with little further modification.

The service center industry is highly fragmented, with as many as 5,000 participants throughout North America, generating in excess of \$80 billion in net sales in 2004. The industry includes both general line distributors that handle a wide range of metal products and specialty distributors that specialize in particular categories of metal products. We are a general line distributor. Metal service centers accounted for approximately one quarter or more of U.S. steel shipments in 2004 based on volume, a market share which has been relatively constant for the last 15 years.

We believe that both primary metals producers and end-users are increasingly seeking to have their metals processing and inventory management requirements met by value-added service centers. During the past two decades, primary metals producers have been focusing on their core competency of high-volume production of a limited number of standardized metal products. As primary metal producers have consolidated, they increasingly require service centers and processors to perform value-added services for end customers. As a result, most end-users can no longer obtain processed products directly from primary metals producers and therefore over 300,000 OEMs, contractors and fabricators nationwide rely on service centers. End-users have also recognized the economic advantages associated with outsourcing their customized metals processing and inventory management requirements. Outsourcing permits end-users to reduce total production costs by shifting the responsibility for pre-production processing to service centers, whose higher efficiencies in performing these processing services make the ownership and operation of the necessary equipment more financially feasible.

Value-added service centers, including ourselves, have also benefited from growing customer demand for inventory management and just-in-time delivery services. These supply-chain services, which are normally not provided by primary metals producers, enable end-users to reduce input costs, decrease capital required for inventory and equipment and save time, labor and other expenses. Some value-added service centers, including us, have installed EDI between their computer systems and those of their customers to facilitate order entry, inventory management, just-in-time delivery and billing.

In addition, manufacturers in general appear to be reducing their operating costs by limiting the number of suppliers with which they do business, often eliminating suppliers offering limited ranges of products and services. Customers are increasingly seeking suppliers capable of providing sophisticated processing services, such as marine coatings and precision laser cutting. These trends have placed small, owner-operated businesses at a competitive disadvantage because they have limited access to the capital resources necessary to increase their capabilities, or they may be unwilling to justify the investment in equipment. As a result, smaller metal service centers are finding it increasingly difficult to compete with larger service centers.

The industry has been consolidating due to the economies of scale and other advantages that the larger metal service centers enjoy. According to industry sources, the number of metal processor and service center locations in the U.S. has been reduced significantly. We believe the larger and more sophisticated companies, like us, enjoy significant advantages over smaller companies in areas such as obtaining higher discounts associated with volume purchases, the ability to service customers with operations in multiple locations and the use of more sophisticated information systems.

Plates and Shapes Group. We believe we are one of the largest distributors of metal plates and shapes in the United States. We sell products such as wide-flange beams, plate, tubing, angles, bars and other structural shapes in a number of alloy grades and sizes. A substantial number of our products undergo additional processing prior to being delivered to our customers, such as blasting and painting, tee-splitting, cambering/leveling, cutting, sawing, punching, drilling, beveling, surface grinding, bending, shearing and cutting-to-length. We sell our products to a fragmented customer base that consists of a large number of small customers who purchase products in small order sizes and require just-in-time delivery. The customers of our Plates and Shapes Group are primarily in the fabrication, construction, machinery and equipment, transportation and energy industries. We serve our customers, who generally operate in a limited geographic region, from 21 metal service centers located primarily in the eastern half of the United States.

Each metal service center is located in close proximity to our metal suppliers and our customers.

Flat Rolled Group. The Flat Rolled Group sells a number of products, including carbon and stainless steel, aluminum, brass and copper in a number of alloy grades and sizes. As relatively few end-user customers can handle carbon steel in the form generally shipped by steel mills (sizes less than a quarter of an inch in thickness in continuous coils that typically weigh 40,000 to 60,000 pounds each), substantially all of the carbon steel material, as well as the nonferrous materials sold by our Flat Rolled Group, undergo additional processing prior to delivery to the customer. We provide a broad range of value-added processing services including precision blanking, slitting, shearing, cutting-to-length, punching, bending and leveling. Our customers are in the electrical manufacturing, fabrication, furniture, appliance manufacturing, machinery and equipment and transportation industries and include many larger customers who value the high quality products that we provide together with our customer service and reliability. A number of our large customers purchase through pricing arrangements or contractual agreements. We serve our customers from 12 metal service centers in the midwestern and southern regions of the United States. Each metal service center is located in close proximity to our metal suppliers and our customers.

Products and Services. We purchase our raw materials in anticipation of projected customer requirements based on interaction with and feedback from customers, market conditions, historical usage and industry research. Primary producers typically find it more cost effective to focus on large volume production and sale of metals in standard sizes and configurations to large volume purchasers. We process the metals to the precise length, width, shape and surface quality specified by our customers. Our value-added processes include:

Precision blanking the process in which metal is cut into precise two-dimensional shapes.

Flame cutting the cutting of metals to produce various shapes according to customer-supplied drawings.

Laser and plasma cutting the cutting of metals to produce shapes under strict tolerance requirements.

Slitting the cutting of coiled metals to specified widths along the length of the coil.

Blasting and Painting the process of cleaning steel plate by shot-blasting, then immediately applying a paint or primer.

Plate forming and rolling the forming and bending of plates to cylindrical or required specifications.

Shearing and cutting to length the cutting of metals into pieces and along the width of a coil to create sheets or plates.

Tee-splitting the cutting of metal beams along the length to form separate pieces.

Cambering the bending of structural shapes to improve load-bearing capabilities.

Sawing the cutting to length of bars, tubular goods and beams.

Leveling the flattening of metals to uniform tolerances for proper machining.

Edge trimming a process that removes a specified portion of the outside edges of coiled metal to produce uniform width and round or smooth edges.

Metallurgy the analysis and testing of the physical and chemical composition of metals.

Our additional capabilities include applications engineering and other value-added processes such as custom machining. Using these capabilities, we use processed metals to manufacture higher-value components.

Once we receive an order, we select the appropriate inventory and schedule it for processing in accordance with the customer's requirements and specified delivery date. Orders are monitored by our computer systems, including, in certain locations, the use of bar coding to aid in and reduce the cost of tracking material. We record the source of all metal shipped to customers. This enables us to identify the source of any metal which may later be shown to not meet industry standards or that fails during or after manufacture. This capability is important to our customers as it allows them to assign responsibility for non-conforming or defective metal to the mill that produced the metal. Many of the products and services we provide can be ordered and tracked through a web-based electronic network that directly connects our computer system to those of our customers.

We cooperate with our customers and tailor our deliveries to support their needs, which in many instances consist of short lead-time and just-in-time delivery requirements. This is accomplished through our inventory management programs, which permit us to deliver processed metals from a sufficient inventory of raw materials to meet the requirements of our customers, which in many instances results in orders filled within 24-48 hours.

While we ship products throughout the U.S., most of our customers are located within a 250-mile radius of our facilities, thus enabling an efficient delivery system capable of handling a large number of short lead-time orders. We transport most of our products directly to our customers either with our own trucks for short-distance and/or multi-stop deliveries or through common or contract trucking companies.

We have quality control systems to ensure product quality and traceability throughout processing. Quality controls include periodic supplier audits, customer approved quality standards, inspection criteria and metals source traceability. A total of 20 of our metal processing/service center facilities have International Standards Organization, or ISO, 9002 certification. In addition to our metal processing/service center facilities that are ISO certified, one location in our Building Products Group is ISO certified.

Building Products Group

Business Overview. The Building Products Group provides diversification to our overall business as both its operations and the end-markets that it serves are significantly different from those of our metal service center business. The Building Products Group manufactures and sells sunrooms, roofing products, awnings and solariums for use in residential applications and large area covered canopies, awnings and covered walkways for use in commercial applications. Approximately 95% of our Building Products Group sales are attributable to the residential remodeling market with the remaining sales attributable to commercial applications. Because our building products business is primarily focused on the residential remodeling market, its sales are not correlated to housing starts or interest rates, nor are they subject to fluctuations in the demand or price of metal. The customers of our Building Products Group are predominantly in the construction, wholesale trade and building material industries. We primarily distribute our products through a network of independent distributors and home improvement contractors. We believe we are the only supplier within our market segment with national scale.

Building Products had net sales of \$183.0 million in 2004 and currently has 18 operating locations and 26 sales and distribution centers throughout the southeast, southwest and western regions of the U.S. The Building Products Group contributed approximately 12% of our 2004 net sales.

Industry Overview. The residential remodeling industry has experienced significant growth over the last 10 years and is poised for continued growth in the future. The Home Improvement Research Institute estimates that homeowners and rental property owners spend approximately \$256.0 billion annually on remodeling their homes which accounts for over 40% of all residential construction and improvement spending. Over the last decade, the industry has experienced accelerated growth due to a number of different macroeconomic and demographic factors including strong existing-home sales, rising disposable incomes, increased rates of home ownership and aging American houses. Existing-home sales impact the remodeling market as owners improve their homes in preparation for sale and new-home buyers often undertake significant renovations and remodeling projects within the first few months of ownership. The increase in disposable incomes has been a factor in the rise in homeownership to over 68% in 2004 from under 64% in 1993. The aging of the domestic home supply is also expected to bolster remodeling sales as the average home in the U.S. is now over 30 years old. As Americans look to improve and upgrade their homes, we believe that an increasing number will turn to remodeling as a cost-effective alternative to new housing construction. Among the most popular remodeling projects are backyard living items, such as pool enclosures, lattices and patio covers, as well as sunrooms and roofing, all of which we manufacture and distribute.

Sources of Supply

In recent years, steel, aluminum, copper and other metals production in the U.S. has fluctuated from period to period as mills attempt to match production to projected demand. Periodically, this has resulted in shortages of, or increased ordering lead times for, some products, as well as fluctuations in price. Typically, metals producers announce price changes with sufficient advance notice to allow us to order additional products prior to the effective date of a price increase, or to defer purchases until a price decrease becomes effective. Our purchasing decisions are based on our forecast of the availability of metal products, ordering lead times and pricing, as well as our prediction of customer demand for specific products.

Edgar Filing: METALS USA INC - Form 8-K

We obtain the overwhelming majority of our raw materials from domestic suppliers, which include Nucor Corp., U.S. Steel, AK Steel, Gerdau Ameristeel, International Steel Group, Alcoa Inc., Bayou Steel, Chaparral Steel and IPSCO Steel. Although we have historically purchased approximately 10% to 15% of our raw material supplies from foreign producers, domestic suppliers have always been and we believe will continue to be our principal source of raw material.

Although most forms of steel and aluminum produced by mills can be obtained from a number of integrated mills or mini-mills, both domestically and internationally, there are a few products that are available from only a limited number of producers. Since most metals are shipped freight-on-board and the transportation of metals is a significant cost factor, we seek to purchase metals, to the extent possible, from the nearest mill, but will use a more distant mill when it offers a lower delivered price.

Ferrous metal producers have been undergoing rapid consolidation over the past three years. U.S. Steel, Nucor Corp. and International Steel Group have acquired several of their domestic competitors, and international integrated producers have merged and consolidated operations. Furthermore, Mittal Steel purchased International Steel Group, creating the largest steel producer in the world. The result of this trend will be fewer integrated producers from which we can purchase our raw materials. While we believe that global consolidation of the steel industry is beneficial to the steel industry as a whole, we are unable to predict what impact this consolidation may have on our operations.

Sales and Marketing; Customers

We employ a sales force consisting of inside and outside salespeople. Inside salespeople are primarily responsible for maintaining customer relationships, receiving and soliciting individual orders and responding to service and other inquiries by customers. Our outside sales force is primarily responsible for identifying potential customers and calling on them to explain our services. The sales force is trained and knowledgeable about the characteristics and applications of various metals, as well as the manufacturing methods employed by our customers.

Our sales and marketing focus is on the identification of OEMs and other metals end-users that could achieve significant cost savings through the use of our inventory management, value-added processing, just-in-time delivery and other services. We use a variety of methods to identify potential customers, including the use of databases, direct mail and participation in manufacturers' trade shows. Customer referrals and the knowledge of our sales force about regional end-users also result in the identification of potential customers. Once a potential customer is identified, our outside salespeople assume responsibility for visiting the appropriate contact, typically the purchasing manager or manager of operations.

Nearly all sales are on a negotiated price basis. In some cases, sales are the result of a competitive bid process where a customer provides a list of products, along with requirements, to us and several competitors and we submit a bid on each product. We have a diverse customer base, with no single customer accounting for more than 2% of our net sales in 2004 and 2003, and 1% in 2002. Less than 4% of our sales are to the automotive industry and we do not sell directly to the Big Three automobile manufacturers.

Competition

We are engaged in a highly fragmented and competitive industry. Competition is based on price, product quality, service, and timeliness of delivery and geographic proximity. We compete with a large number of other metals processors/service centers on a national, regional and local basis, some of which may have greater financial resources. We also compete to a lesser extent with primary metals producers, who typically sell directly to very large customers requiring regular shipments of large volumes of metals. Numerous smaller metals processors/service centers compete with us locally.

Historically, we believe that we have been able to compete effectively because of our significant number of locations, geographic dispersion, knowledgeable and trained sales force, integrated computer systems, modern equipment, broad-based inventory, combined purchasing volume and operational economies of scale. Furthermore, we believe our liquidity and overall financial position affords us a good platform with which to compete with our peers in the industry.

Government Regulation and Environmental Matters

Our operations are subject to a number of federal, state and local regulations relating to the protection of the environment and to workplace health and safety. In particular, our operations are subject to extensive federal, state and local laws and regulations governing waste disposal, air and water emissions, the handling of hazardous substances, environmental protection, remediation, workplace exposure and other matters. Hazardous materials we use in our operations include general commercial lubricants and cleaning solvents. Among the more significant regulated activities that occur at some of our facilities are: the accumulation of scrap metal, which is sold for recycling; the generation of plant

Edgar Filing: METALS USA INC - Form 8-K

trash and other solid wastes and wastewaters, such as water from burning tables operated at some of our facilities, which wastes are disposed of in accordance with the Federal Water Pollution Control Act and the Resource Conservation and Recovery Act using third party commercial waste handlers; the storage, handling, and use of lubricating and cutting oils and small quantities of maintenance-related products and chemicals, the health hazards of which are communicated to employees pursuant to Occupational Safety and Health Act-prescribed hazard communication efforts and the disposal or recycling of which are performed pursuant to the Resource Conservation and Recovery Act.

Generally speaking, our facilities' operations do not involve the types of emissions of air pollutants, discharges of pollutants to land or surface water, or treatment, storage, or disposal of hazardous waste which would ordinarily require federal or state environmental permits. Some of our facilities possess authorizations for air emissions from paints and coatings, hazardous materials permits under local fire codes or ordinances for the storage and use of small quantities of combustible materials such as oils or paints, and state or local permits for on-site septic systems. Our cost of obtaining and complying with such permits has not been and is not anticipated to be material. Our operations are such that environmental regulations typically have not required us to make significant capital expenditures for environmental compliance activities, and ongoing operational costs relating to environmental compliance are limited.

We believe that we are in substantial compliance with all applicable environmental and workplace health and safety laws and do not currently anticipate that we will be required to expend any substantial amounts in the foreseeable future in order to meet such current requirements. However, some of the properties we own or lease are located in areas with a history

of heavy industrial use, and are on or near sites listed on the CERCLA National Priority List. CERCLA establishes joint and several responsibility for clean-up without regard to fault for persons who have arranged for disposal of hazardous substances at sites that have become contaminated and for persons who own or operate contaminated facilities. We have a number of properties located in or near industrial or light industrial use areas; accordingly, these properties may have been contaminated by pollutants which would have migrated from neighboring facilities or have been deposited by prior occupants. Some of our properties are affected by contamination from leaks and drips of cutting oils and similar materials used in our business and we have removed such and restored such known impacted soils pursuant to applicable environmental laws. The costs of such clean-ups have not been material. We are not currently subject to any claims or notices with respect to clean-up or remediation under CERCLA or similar laws for contamination at our leased or owned properties or at any off-site location. However, we cannot rule out the possibility that we could be notified of such claims in the future. It is also possible that we could be identified by the Environmental Protection Agency, a state agency or one or more third parties as a potentially responsible party under CERCLA or under analogous state laws.

Management Information Systems

Both the Plates and Shapes Group and Flat Rolled Group service centers use a system marketed and distributed specifically for the service center industry. During 2003, we completed a similar common-platform initiative in the Building Products Group. Some of our subsidiaries currently use EDI, through which they offer customers a paperless process with respect to order entry, shipment tracking, billing, remittance processing and other routine activities. Additionally, several of our subsidiaries also use computer-aided drafting systems to directly interface with computer-controlled metal processing equipment, resulting in more efficient use of material and time.

We believe investment in uniform management information systems and computer-aided manufacturing technology permits us to respond quickly and proactively to our customers' needs and service expectations. These systems are able to share data regarding inventory status, order backlog, and other critical operational information on a real-time basis.

Employees

We employ approximately 2,500 persons. As of September 30, 2005, approximately 300 employees (12%) at various sites were members of unions: the United Steelworkers of America; the Sheet Metals Workers Union; the International Association of Bridge, Structural, and Ornamental Ironworkers of America; the International Brotherhood of Teamsters; and the International Brotherhood of Boilermakers, Iron Ship Builders, Blacksmiths, Forgers and Helpers. Our relationship with these unions generally has been satisfactory, but occasional work stoppages have occurred. Within the last five years, one work stoppage occurred at one facility, which involved approximately 30 employees and lasted approximately 30 days. We are currently a party to 9 collective bargaining agreements, which expire at various times. Collective bargaining agreements for all of our union employees expire in each of the next three years. Historically, we have succeeded in negotiating new collective bargaining agreements without a strike. The largest collective bargaining agreement, which is at the Northbrook site and covers approximately one-third of our unionized employees, was recently renewed for another three years.

From time to time, there are shortages of qualified operators of metals processing equipment. See **Risk Factors** **Risks Related to Our Business**. Adverse developments in our relationship with our employees and future shortages of employees could adversely affect our business. In addition, during periods of low unemployment, turnover among less-skilled workers can be relatively high. We believe that our relations with our employees are satisfactory.

Vehicles

We operate a fleet of owned or leased trucks and trailers, as well as forklifts and support vehicles. We believe these vehicles are generally well maintained and adequate for our current operations.

Risk Management and Insurance

The primary risks in our operations are bodily injury, property damage and vehicle liability. We maintain general and vehicle liability insurance and liability insurance for bodily injury and property damage and workers' compensation coverage, which we consider sufficient to protect us against a catastrophic loss due to claims associated with these risks.

Safety

Our goal is to provide an accident-free workplace. We are committed to continuing and improving upon each facility's focus and emphasis on safety in the workplace. We currently have a number of safety programs in place, which include regular weekly or monthly field safety meetings and training sessions to teach proper safe work procedures. We have developed a comprehensive "best practices" safety program to be implemented throughout our operations to ensure that all employees comply with our safety standards, as well as those established by our insurance carriers, and federal, state and

local laws and regulations. This program is led by the corporate office, with the assistance of each of our product group presidents, executive officers and industry consultants with expertise in workplace safety. Furthermore, we pay bonuses based on an employee's or a team's safety record.

Financial Information about Segments

For information regarding revenues from external customers, measures of profit or loss and total assets for the last three years for each segment, see the Segment Results discussions in Management's Discussion and Analysis of Financial Condition and Results of Operations.

Patents and Trademarks

We own several U.S. patents, trademarks, service marks and copyrights. Certain of the trademarks and patents are registered with the U.S. Patent and Trademark Office, and, in some cases, with trademark offices of foreign countries. We consider other information owned by us to be trade secrets. We protect our trade secrets by, among other things, entering into confidentiality agreements with our employees and implementing security measures to restrict access to such information. We believe that our safeguards provide adequate protection to our proprietary rights. While we consider all of our intellectual property to be important, we do not consider any single intellectual property right to be essential to our operations as a whole.

Seasonal Aspects, Renegotiation and Backlog

There is a slight decrease in our business during the winter months because of inclement weather conditions and the impact on the construction industry. No material portion of our business is subject to renegotiation of profits or termination of contracts at the election of the government. Because of the just-in-time delivery policy and the short lead-time nature of our business, we do not believe the information on backlog of orders is material to an understanding of our business.

Foreign Operations

We do not derive any material revenue from foreign countries and do not have long-term assets or customer relationships outside of the U.S. We have no foreign operations or subsidiaries.

Research and Development

We do not incur material expenses in research and development activities but do participate in various research and development programs. We address research and development requirements and product enhancement by maintaining a staff of technical support, quality assurance and

engineering personnel.

Legal Proceedings

We are involved in a variety of claims, lawsuits and other disputes arising in the ordinary course of business. We believe the resolution of these matters and the incurrence of their related costs and expenses should not have a material adverse effect on our consolidated financial position, results of operations or liquidity. See Risk Factors Risks Related to Our Business We are subject to litigation.

Manufacturing and Facilities

Properties

As of September 30, 2005, we operated 21 metals processing facilities in the Plates and Shapes Group and 12 facilities in the Flat Rolled Group. These facilities are used to receive, warehouse, process and ship metals. These facilities use various metals processing and materials handling machinery and equipment. Our Building Products Group operates 18 facilities where we process metals into various building products and 26 sales and distribution centers. During 2004, nine Building Products locations were closed and two locations were merged. We continue to serve the marketing areas of the closed facilities with our existing sales force by expanding the responsible territories of our other facilities, and through the use of common carrier for product delivery.

Many of our facilities are capable of being used at higher capacities, if necessary. We believe that our facilities will be adequate for the expected needs of our existing businesses over the next several years. Our facilities, sales and distribution centers and administrative offices are located and described as follows, as of September 30, 2005:

Edgar Filing: METALS USA INC - Form 8-K

	Location	Square Footage	Owned/Leased
<i>Plates and Shapes Group:</i>			
Northeast Plates and Shapes	Baltimore, Maryland	65,000	Leased
	Seekonk, Massachusetts	115,000	Owned
	Newark, New Jersey(1)	81,000	Leased
	Langhorne, Pennsylvania	235,000	Leased
	Philadelphia, Pennsylvania	85,000	Owned
	York, Pennsylvania	109,000	Owned
South Central Plates and Shapes	Enid, Oklahoma	112,000	Leased
	Muskogee, Oklahoma(2)	229,000	Owned
	Cedar Hill, Texas	104,000	Owned
Mid-Atlantic Plates and Shapes	Ambridge, Pennsylvania		