Q3 2007 Earnings Call

Company Participants

- Bill Dickert, COO
- Cary Baetz, Treasurer
- Celtyn Hughes, CFO
- Tommy Valenta, CEO

Other Participants

- Alex Mitchell, Analyst
- Barry Vogel, Analyst
- Brett Levy, Analyst
- Chris DeYoung, Analyst
- Dan Wimsatt, Analyst
- Michelle Appelbaum, Analyst
- Mouk Faltsa, Analyst
- Scott Moore, Analyst
- Timothy Hayes, Analyst

Presentation

Operator

Good day, ladies and gentlemen. Welcome to the Third Quarter 2007 Chaparral Steel Company Earnings Conference Call. My name is James and I will be your operator for today. (Operator Instructions). As a reminder, this conference is being recorded for replay purposes. I would now like to turn the call over to Mr. Cary Baetz, Vice President and Treasurer. Please proceed, sir.

Cary Baetz {BIO 7384900 <GO>}

James, thank you. Good morning to everyone. Welcome to Chaparral's Third Quarter Fiscal Year 2007 Earnings Release Teleconference. With us today is Tommy Valenta, the CEO of Chaparral Steel; Celtyn Hughes, the CFO; and Bill Dickert, the COO. Our format will be as it's been in the past teleconferences. We'll start with a brief comment from Management. And then, we'll move to the Q&A session.

Before we begin, we'd like to remind you that certain statements made in this teleconference may be forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to risks, uncertainties. And other factors, which could cause actual results to differ materially from future results expressed or implied by such forward-looking statements.

Potential risks and uncertainties include. But are not limited to, the impact of competitive pressures and changing economic and financial conditions on the company's business; construction activity in the company's markets; changes in cost of raw materials, fuel. And energy; the impact of environmental laws; unexpected equipment failures; the effect of foreign currency valuations; and regulatory and statutory changes, which are more fully described in the company's annual report on Form 10-K filed with the SEC. With that, I'll turn things over to Tommy for his opening comments. Tommy, please go ahead.

Tommy Valenta {BIO 1437548 <GO>}

Thank you, Cary. Good morning, everyone. There are only a few points I want to touch on this morning. So I'll keep my comments relatively short. And then let Celtyn give you the details of our financial results and our outlook for the Fourth Quarter. It was another great quarter. I am proud to announce that it was our second best quarter in our company's history in what is usually our slowest quarter. I believe these results continue to demonstrate the strength of our market.

The market conditions are good. The outlook is still very positive for non-residential construction, especially the industrial sector. Estimates for non-residential growth for calendar 2007 is approximately 6 to 8%. We fully expect all structural producers to be running their plants at over 90% of their rated capacity. 2007 should be a very good year.

We've seen substantial rises in scrap prices over the last few months. Since December, the price of scrap has gone up about $145 per gross ton. This is because international demand for scrap remains high. We're now seeing the domestic market catch up as winter weather conditions have had a significant impact on scrap collections and transportation. That coupled with increased utilization from flat roll producers has the domestic market tight. We believe that scrap prices will start to moderate as we progress into late spring and early summer and supply lines open again.

The good news is that the increase in raw material costs and continued strong demand throughout the world has driven up international prices of beams. International prices continue to increase and this has resulted in price increases of approximately $100 per ton in the last three months in the U.S. Imports are not a major factor in the market today. They remain very manageable at about 10%.

The importer has to bear the cost of transportation, currency valuations. And the uncertainty and timing of delivery. That alone makes the structural steel market in the U.S. a less than desirable market for an importer. However, when you layer on strong markets abroad for beams, it only adds to the dynamic. International beam producers now have more attractive markets in which to move their product.

As we continually look for ways to maintain our competitive position, we have some possible exciting news about our future energy costs at our Texas facility. Our plant and the land that we own around it appears to be included in the Barnett Shale gas formation. We can stand at our back door and see several drilling rigs in operation. We've known for some time about the possibility of having gas under our property. It is still an unknown. But we have recently entered into a contract to drill our property.

The opportunity has us receiving a 25% royalty payment. And the option to obtain a 50% working interest in all of the wells built on our property. It is much too early to talk about what this means to Chaparral until the exploration activity is completed. This is just another example of the ways we're exploring to lower our costs and maintain our competitive position as a world class structural steel producer.

Now, on a subject I'm sure a lot of you have questions about, our large cash balance. As I've alluded to in every teleconference, the company is very focused on shareholder value and doing the right things for shareholders through a complete cycle. With that said, we're continually working on strategic growth opportunities, both organic and external. It is a challenge that many smart people within this great organization are working on today. Until some conclusions are made on these opportunities, we'll continue to build cash, pay a dividend. And be opportunistic with stock repurchases.

By the way, we did have a small window of opportunity to repurchase about 213,000 shares during the quarter and will continue to look for the right opportunities to buy back more. It's important for everyone to understand we will be deliberate and thoughtful on any investment we make. We will be good stewards of the company's assets. If it does not meet our return criteria, we don't feel pressured to make marginal investments.

In closing, our focus at Chaparral remains to do the right things for our shareholders for the long term. We will continue to work every day to do just that. That concludes my comments. And thank you for joining us on this call. I'll now pass it over to Celtyn to talk about the financial results for the quarter and give our guidance for next quarter.

Celtyn Hughes

Thank you, Tommy. Good morning, everyone. First, I'll comment on our results. And then our outlook for the Fourth Quarter. This was our second best quarter ever in what's historically our weakest seasonal quarter. In addition, it was the best Third Quarter in our history. Net income of 62.5 million, or $1.29 a diluted share, was 27% better than the same quarter last fiscal year, which was 49.2 million, or $1.03 a share. Excluding the business interruption payment that we had last quarter, this quarter was only 2% less than the record set last quarter. And our operating profit of 101.3 million exceeded our comparable quarter of last fiscal year by 23%.

Shipments of 567,000 tons were seasonally strong and were similar to the Third Quarter of last year. And were 26,000 tons higher than last quarter. Planned outages at both of our facilities led to production at 83% of capacity, compared to 89% last quarter. We aren't projecting any shutdowns in our Fourth Quarter. So we should have solid production going into our seasonally busiest time.

Average selling prices were slightly lower than last quarter by $3 as a result of product mix, while wide flange beam prices were higher by $4. Metal margins were similarly lower by $3. And cost of scrap charged was flat with last quarter. Since the end of the quarter, we've had two scrap driven price increases for structural products; $25 for March and $50 for April. We continue to focus on the international prices, which are also moving up as a result of higher raw material costs and strong demand.

As anticipated, energy cost for the quarter was 12% higher compared to last quarter as a result of higher natural gas prices. And going forward, we've locked in heat rates for the summer and the hurricane season, which goes through October. And are monitoring gas opportunities to lock in a lower total power cost for that period.

SG&A expense was up 2.2 million compared to last quarter, primarily as a result of additional coverage elections by participants in our financial security plan. And that's a non-qualified contributory defined benefit plan. Interest expense was in line with both the sequential and comparative quarter of last year. This quarter we had 7.3 million of LIFO charge, compared to a charge of 1.9 million last quarter, primarily due to rising scrap prices.

Capital expenditures were 5.7 million during the quarter. And we anticipate spending about 22 to 23 million for the fiscal year. Depreciation for the quarter was 11.8 million. Our balance for cash, cash equivalents. And short-term investments was 365.5 million. And we paid a quarterly dividend of $0.10 a share on February 15. And as Tommy said, we repurchased 213,800 shares of common stock at an average price of 44.65.

As far as the forecast, based on current market conditions, the Fourth Quarter should continue to provide strong results. We believe that end user demand for our products will remain strong. Historically, shipments in the Fourth Quarter are stronger than the third. But due to strong shipments last quarter, we're forecasting similar volumes for the Fourth Quarter. Domestic and international scrap markets are at historic highs. International structural prices have improved. And we'll continue to price our products favorable to the imports.

The prospects for higher energy costs due to warmer weather could have a negative impact on margins compared to the Third Quarter. And as a result, we anticipate net income to be around $1.35 per diluted share for the Fourth Quarter. That's my comments, Cary. And I'll turn it back to you.

Cary Baetz {BIO 7384900 <GO>}

Celtyn, thank you. James, if you want to open it up for questions, we're ready. Thank you.

Questions And Answers

Operator

(Operator Instructions). Your first question comes from the line of Michelle Appelbaum of Michelle Appelbaum Research. Please proceed.

Q - Michelle Appelbaum

Hi. Tommy, you talk faster than I can write. Go through again what the prices in the U.S. on beams versus the potential competition offshore.

A - Bill Dickert {BIO 7379538 <GO>}

Michelle, this is Bill Dickert. I'll answer that. In the April price list we put an average price for U.S. beams around $770. The international price is just slightly above that. And if you look at just strictly Europe, Europe is around 820 right now.

Q - Michelle Appelbaum

Okay. So there's--it's not even close. Okay. Then, what's the May price and what's happening with metal spreads? You've got scrap prices going vertical. And let's just say it doesn't ease off. Let's just say flat in the next few--let's say everything's flat in the next few months. What's happening to your metal spreads?

A - Bill Dickert {BIO 7379538 <GO>}

Well they're staying fairly flat. Our forecast is the Fourth Quarter will be up just slightly. I mean, we've had--like I said, we've had two price increases. You don't know what May will do at this point, whether it's going to go up or down or flat. But the margins--the metal margins have expanded just slightly.

Q - Michelle Appelbaum

Okay. And do you anticipate they could expand further with prices offshore if scrap goes down or stays the same?

A - Bill Dickert {BIO 7379538 <GO>}

If the offshore pricing is increased, well, I'm sure that we will be opportunistic in our pricing.

Q - Michelle Appelbaum

Okay. Next question. In terms of acquisitions, Tommy, can you talk a little bit conceptually--just conceptually about what makes sense, what kind of things you're looking for?

A - Tommy Valenta {BIO 1437548 <GO>}

Michelle, what we've said in the past and we'll say today also is that we're looking--we can look for opportunities either upstream or downstream or even within the niche. We're looking for--we would look for strong players that have niches in markets and not commodity driven activities. There's the potential for expanding our scrap activities and also looking at distribution opportunities.

Q - Michelle Appelbaum

Okay. And size-wise?

A - Tommy Valenta {BIO 1437548 <GO>}

Well we're limited to what we can look at by our own size. So you'll have to put your own parameters around that one.

Q - Michelle Appelbaum

Okay. But do you have limits on the down--I mean, sometimes I've heard some companies say they'd rather do a big acquisition than a small acquisition because it takes as much time and cost. Do you have any preferences?

A - Tommy Valenta {BIO 1437548 <GO>}

I think that what you just said is absolutely true as far as size is concerned. But they don't always come that way. You have to look at the opportunities as they come to you.

Q - Michelle Appelbaum

And you had talked a little bit about your background doing acquisitions at TXI. Can you talk a little bit about like philosophically your view on acquisitions. And just a little bit about your experience doing them in the past?

A - Tommy Valenta {BIO 1437548 <GO>}

I can. That's a long time ago and I'll try to dredge up that memory. But I guess I was involved in probably 20 or 25 acquisitions on the cement aggregate and concrete side for over 20 years. Either buying assets for the most part and trying to integrate the cultures or whatever, it's--the key issue you have in any acquisition is understanding what their business is and the real value that they add to you. So I would say that the acquisition business is not new to any of us on this team. It's just a matter of being able to find the right fit.

Q - Michelle Appelbaum

Okay. Great. Thanks.

A - Tommy Valenta {BIO 1437548 <GO>}

Thanks, Michelle.

Operator

Your next question comes from the line of Chris DeYoung of Schroders. Please proceed.

Q - Chris DeYoung

Good morning, guys.

A - Tommy Valenta {BIO 1437548 <GO>}

Good morning.

Q - Chris DeYoung

Not to flog that question too much. But just to sort of piggyback on it quickly. In terms of strategic growth and potential acquisition opportunities, you had said that you would look for sort of a non-commodity player, a niche player. Would you still require yourselves to be focused only on sort of the beam and bar space, or would you look possibly into other grades. But say within structural steel, for example, a plate manufacturer?

A - Tommy Valenta {BIO 1437548 <GO>}

To answer your question with regard to beams, we would say that we're looking for niches in any steel market.

Q - Chris DeYoung

Okay.

A - Tommy Valenta {BIO 1437548 <GO>}

Again, it could be driven by customers, it could be driven by our own expertise. But I think that niches are going to be driven more by the product.

Q - Chris DeYoung

Okay. Okay, perfect. And a quick follow-on question. You mentioned strength in the non-residential construction sector. And in particular in the--you said the industrial sector. How are you defining that? When you say strengthening the industrial sector, specifically what do you mean?

A - Tommy Valenta {BIO 1437548 <GO>}

What we talk about there is basically the petrochemical industry, the energy--I mean, the electricity industry, the people that are building the power plants, the cement plants, things like that that typically run in pretty high cycles. And we--for example, here in Texas, one of the major utilities has announced a number of new facilities to be built in the state over the next few years.

And there's a number of those activities across the country. The petrochemical industry along our Gulf coast and going into Canada is extremely strong. Those are the kind of projects that you don't see often.

Q - Chris DeYoung

Okay.

A - Tommy Valenta {BIO 1437548 <GO>}

But they're very strong right now.

Q - Chris DeYoung

Does that also extend to just say an increase in manufacturing capacity offshore?

A - Tommy Valenta {BIO 1437548 <GO>}

It increases manufacturing capacity onshore.

Q - Chris DeYoung

Yes. No. When you say growth in the industrial sector are you also referring to people building manufacturing capacity?

A - Tommy Valenta {BIO 1437548 <GO>}

Yes.

Q - Chris DeYoung

Okay. All right. Thank you, much.

A - Tommy Valenta {BIO 1437548 <GO>}

Thanks, Chris.

Operator

Your next question comes from the line of Brett Levy of Jefferies and Company. Please proceed.

Q - Brett Levy {BIO 3061193 <GO>}

Let's start out with where is the dividend basket right now in terms of total size of a one-time dividend at this point?

A - Celtyn Hughes

The restricted payments basket, again, grows. Last quarter it was at 100 million. Then you add just about--you add half of the net income and subtract out for the share repurchase and the dividend. So today, Brett, I haven't look at it. But you're going to be probably right around 120 total.

Q - Brett Levy {BIO 3061193 <GO>}

Got it. All right. Then, in terms of what you guys do and then maybe even what you see going on away from you in beams. Are both plants completely in balance in terms of like the melt shop capacity and the rolling mill capacity? Is there an easy CapEx project to enable you to produce a little bit more that you guys are looking at? Or are both of those completely in balance?

A - Celtyn Hughes

For the product mix that we're running now, they are in balance pretty much. And like we always do, we're looking for what bottlenecks may be there, if we'd want to concentrate on certain products to improve the throughput. But for the most part, they're in balance.

Q - Brett Levy {BIO 3061193 <GO>}

All right. Then, in terms of anything, it sounds like you're mostly looking in the direction of acquisitions. Is anything greenfield potentially being considered as well? I mean, I guess I feel like when we start getting into the zip code of six multiples for almost everything at least, maybe the build out can start to make sense again.

A - Tommy Valenta {BIO 1437548 <GO>}

Brett, as we mentioned in last quarter's teleconference, we talked about the possible expansion opportunity that we might have at our Virginia facility. And those evaluations are still underway. And we need just a little bit more time to be able to work out what the outcome of that is.

Q - Brett Levy {BIO 3061193 <GO>}

Okay. But it's--there's not something that seems like sort of a lay-up expansion relative to the cost of buying something else?

A - Tommy Valenta {BIO 1437548 <GO>}

Not to date.

Q - Brett Levy {BIO 3061193 <GO>}

Okay. Then, you said you locked in your heat costs. Could you talk about what percentage of costs that is and what you locked it in at?

A - Tommy Valenta {BIO 1437548 <GO>}

Well whenever you buy--you can buy electricity or you can be opportunistic and--electricity prices are based--are made up of two pieces. It's the heat rate, which is basically everything, including profits and everyone--everything from the power producers. And natural gas. That's the two pieces. And you can actually go out and buy heat rates for periods of time.

Typically, heat rates are higher whenever gas is low and lower whenever gas is high. And so, what we do is we buy the heat rate during a portion of the year which is usually early in the cycle that we're trying to cover. And then as gas prices retreat a little bit, we'll start locking in layers of gas. And at the end of the day, we've got all of our power bought.

Q - Brett Levy {BIO 3061193 <GO>}

All right. Then, lastly, are you still considering de-levering as a priority?

A - Celtyn Hughes

We have an opportunity, yes. I mean, our bonds are trading at 112 or so. And if they were a little bit lower, why it would be advantageous for our shareholders if we did.

Q - Brett Levy {BIO 3061193 <GO>}

Got it. Thanks very much, guys. Congrats on another strong quarter.

A - Celtyn Hughes

Thanks, Brett.

Operator

Your next question comes from the line of Barry Vogel of Barry Vogel and Associates. Please proceed.

Q - Barry Vogel

Good morning, gentlemen.

A - Tommy Valenta {BIO 1437548 <GO>}

Good morning, Barry.

A - Celtyn Hughes

Good morning, Barry.

Q - Barry Vogel

First of all, I want to ask I guess Bill Dickert, could you tell us what the operating rate for Virginia was in the Third Quarter and what it was in each of the structural--in the structural mill and the bar mill in Texas in the Third Quarter?

A - Bill Dickert {BIO 7379538 <GO>}

What I can give you is Texas combined. I don't have the individual breakout. For the quarter, Texas was 88% utilization and Virginia was 76. Now, in both of those--in Texas we had a five-day outage on our melt shop and the various mills had downtime associated with that five days. And in Virginia, we had a scheduled six-day outage on the rollings.

Q - Barry Vogel

Okay. And what are you projecting when you make this $1.35 projection? What are you projecting the operating rate for Virginia would be in the Fourth Quarter and in Texas in the Fourth Quarter?

A - Bill Dickert {BIO 7379538 <GO>}

As we stand today, we do not have any scheduled downtime for the Fourth Quarter.

Q - Barry Vogel

So what was--so assuming nothing happens at your steel mills, what would you say the operating rate should probably be?

A - Bill Dickert {BIO 7379538 <GO>}

It's going to be around 93.

Q - Barry Vogel

Okay. And if that happens, Celtyn, that would increase profits? Am I correct?

A - Celtyn Hughes

Well we have a great sense of our forecast. And yes, hopefully it would because we'd be making more products to ship.

Q - Barry Vogel

Okay. And Tommy, can you tell us where you are in the product line--in the piling product line at Virginia? Because I know you've added some products over the last couple of years. And what's your best guess for total shipments and tonnage for Virginia in fiscal '07? And what might be the percentage of piling?

A - Tommy Valenta {BIO 1437548 <GO>}

The new price, I mean, we just added some foot weights and sizes to the beams. And then we continue to work on the various sizes of sheet pile. This year, we've commissioned the PVC-26 that complements the 13 and 18 size sheet pile.

Q - Barry Vogel

All right. So for fiscal '07, approximately what's your best guess for tonnage out of Virginia and how much would be piling and how much would be structuring?

A - Tommy Valenta {BIO 1437548 <GO>}

On the piling, probably about 110.

Q - Barry Vogel

Is that down from last year?

A - Tommy Valenta {BIO 1437548 <GO>}

It's down a little bit from last year, yes. That was intentional on our part with the strong beam market.

Q - Barry Vogel

Okay. So what do you--if you didn't have that stronger beam market, what's your capability of shipping tons for piling let's say for fiscal '08?

A - Tommy Valenta {BIO 1437548 <GO>}

Well I mean, if you take beams away, I mean, that number increases tremendously.

Q - Barry Vogel

Okay.

A - Tommy Valenta {BIO 1437548 <GO>}

I mean. And it strictly is scheduled time on your mills.

Q - Barry Vogel

Okay. And as far as the supposed inventory correction. And I don't know if there was any in your beam business. But obviously there was an inventory correction that started around December and January and it seems that the industry did a very good job again in having discipline. Would you say that in terms of the beam business and the piling business, is any--is there--are there excess inventories at the distributor level?

A - Tommy Valenta {BIO 1437548 <GO>}

No. I mean, the distributors, if you look at their inventory, if you (inaudible), last year is a little bit high. But you have to factor in that the mill roll schedules have expanded. So therefore, the service centers have to carry a little more inventory to make up the expansion in the mill schedule. So from an inventory standpoint, we don't see an issue today.

Q - Barry Vogel

Now, as far as your ability to produce product relative to demand, you still seem to be behind the curve. How do you cure that?

A - Tommy Valenta {BIO 1437548 <GO>}

When you say behind the curve, I mean, there are some imports that are coming in that are fitting well within the domestic market today. And there's things you can do as far as tweaking your product mix, where some products that will run more tons per hour through the mills--we'll do that as the market changes.

Q - Barry Vogel

All right. So essentially, if we had to look at what your effective capacity is currently with what your schematic is, would you say it's a little bit less than 2 million tons in structurals and 350,000 tons thereabouts in bar?

A - Tommy Valenta {BIO 1437548 <GO>}

I'd say probably 2 million--2.1 million on beams and probably 250,000 in the bar side; 250 to 300.

Q - Barry Vogel

Okay. Thanks very much. Keep up the good work.

A - Tommy Valenta {BIO 1437548 <GO>}

Thank you, Barry.

A - Celtyn Hughes

Thanks, Barry.

A - Tommy Valenta {BIO 1437548 <GO>}

Have a good day.

Q - Barry Vogel

Thanks.

Operator

Your next question comes from the line of Mouk Faltsa of Longbow Research. Please proceed.

Q - Mouk Faltsa

Good morning.

A - Tommy Valenta {BIO 1437548 <GO>}

Good morning.

Q - Mouk Faltsa

Hi. You talked a lot about the structural side of your business. I was wondering if you could spend some time talking about your outlook for bars.

A - Tommy Valenta {BIO 1437548 <GO>}

The bar side of the business is a little bit soft or it has been the past quarter. Our order intake has increased going into the Fourth Quarter. But it will still be a little bit soft from '06.

Q - Mouk Faltsa

Okay.

A - Tommy Valenta {BIO 1437548 <GO>}

And what we're doing is we're taking that melt and divert it to the structural mills.

Q - Mouk Faltsa

Okay. Overall, for bars and structural, how far forward are you booking business at this point?

A - Tommy Valenta {BIO 1437548 <GO>}

We're booking about 90 days ahead.

Q - Mouk Faltsa

Okay. And as prices are rising, specifically in beams, I'm just wondering if that's going to have any affect on your shipping radius allowing you to sell into markets where you normally don't participate in?

A - Tommy Valenta {BIO 1437548 <GO>}

Really, that's not going to have a difference. I think what we do is we make sure we take care of the customer base that we're doing business with. And make sure that they have the supplies they need to meet their customer needs. So we're not out looking for new business.

Q - Mouk Faltsa

Okay. And any further acquisitions? You spoke some about it. Would they take place in the markets you're currently operating in, or would you be looking for something in a different part of the domestic market?

A - Tommy Valenta {BIO 1437548 <GO>}

Well as I said earlier, we would consider going outside our traditional markets as long as we felt like it was a strong niche.

Q - Mouk Faltsa

Okay. Well thank you very much.

A - Tommy Valenta {BIO 1437548 <GO>}

Thank you.

Operator

Your next question comes from the line of Alex Mitchell of Scopus Asset Management. Please proceed.

Q - Alex Mitchell {BIO 17996412 <GO>}

Good morning. Can you just talk a little bit further about your outlook for scrap? I guess you were saying that you think it goes up a little bit more, then kind of flattens out. Is that a seasonal comment that you were making?

A - Tommy Valenta {BIO 1437548 <GO>}

Yes. Scrap is seasonal. And it has gone up in the last two months from--what was it--what's the beginning number--it's gone up $70 last month and $40 the previous month that the index has.

Q - Alex Mitchell {BIO 17996412 <GO>}

Right.

A - Tommy Valenta {BIO 1437548 <GO>}

So looking at--every month scrap is repriced. And depending on how much supply comes out of the woodworks during the period that we're in right now, we'll determine what May does. And so, it's very difficult. I mean, you do get some seasonality. But it's very difficult to project in any given month what scrap's going to do. And of course, we price--we reprice every month.

Q - Alex Mitchell {BIO 17996412 <GO>}

Right.

A - Tommy Valenta {BIO 1437548 <GO>}

It's on the scrap index.

Q - Alex Mitchell {BIO 17996412 <GO>}

I guess it's also difficult to project the international demand.

A - Tommy Valenta {BIO 1437548 <GO>}

Well I mean, they keep telling us that international demand is very strong. And of course, that does have an impact on--because there's a lot of import--exports from the U.S. also.

Q - Alex Mitchell {BIO 17996412 <GO>}

Longer term, this year or next year, what do you think the outlook for scrap is? Because there is more mini-mill capacity coming out. So--.

A - Tommy Valenta {BIO 1437548 <GO>}

Well I think that we've seen new levels and, if you go back three or four years ago, scrap had been $80 to $100 for a decade or more. And I think that we're in a different world as far as what scrap price is going to be going forward. I think it's probably going to range anywhere from 250 to 350. I mean, this is just a guess on my part--for an extended period of time. I mean, it could go even higher.

Q - Alex Mitchell {BIO 17996412 <GO>}

Well would you--I know it's difficult because there are other variables involved here. But would you expect that--you just--longer term that scrap keeps increasing?

A - Tommy Valenta {BIO 1437548 <GO>}

There's a maximum price for scrap out there. But I think the question you were alluding to earlier was the fact that we've got new capacity in the U.S. coming on. The U.S. has historically been an exporter of scrap; anywhere between 8 and 12 to 13 million tons a year. All that means is some of those tons will stay at home. The international market will still be fed by a portion of it. But some of those tons will stay here. And I think another factor you have to put in there is iron--the price of iron ore. I mean, there is a correlation between scrap and iron ore at the end of the day.

Q - Alex Mitchell {BIO 17996412 <GO>}

But obviously, scrap's done a lot more than iron ore has so far this year.

A - Tommy Valenta {BIO 1437548 <GO>}

For short periods of time. But I mean, I think when you look through it, it's still going to seek a level that will be centered around the ore.

Q - Alex Mitchell {BIO 17996412 <GO>}

Are you--in that environment are you satisfied with your level of integration and--?

A - Tommy Valenta {BIO 1437548 <GO>}

--At this point in time, yes.

Q - Alex Mitchell {BIO 17996412 <GO>}

Okay. And for the next quarter, do you--are you budgeting in the LIFO charge? (Multiple Speakers).

A - Tommy Valenta {BIO 1437548 <GO>}

LIFO? Yes.

Q - Alex Mitchell {BIO 17996412 <GO>}

Is there a range that we should be using?

A - Tommy Valenta {BIO 1437548 <GO>}

For (inaudible), I think we've got somewhere around 4 million in ours.

Q - Alex Mitchell {BIO 17996412 <GO>}

I'm sorry. 4 million?

A - Tommy Valenta {BIO 1437548 <GO>}

4 million, yes.

Q - Alex Mitchell {BIO 17996412 <GO>}

All right. Thank you very much.

A - Tommy Valenta {BIO 1437548 <GO>}

Thank you, Alex.

Operator

Your next question comes from the line of Timothy Hayes of Davenport. Please proceed.

Q - Timothy Hayes {BIO 3823493 <GO>}

Good morning.

A - Tommy Valenta {BIO 1437548 <GO>}

Good morning.

A - Celtyn Hughes

Good morning.

Q - Timothy Hayes {BIO 3823493 <GO>}

A couple of questions about the quarter. Did you see any material improvement in mix or vice versa from Q2 to Q3?

A - Tommy Valenta {BIO 1437548 <GO>}

If you're--yes. The overall product mix, we had--on the SBQ side, we had a little bit more rebar and less SBQ. Other than that, the mix was comparable to previous quarters.

Q - Timothy Hayes {BIO 3823493 <GO>}

Okay. Then, the SG&A expensing, a bit high. What's your guidance for that over the next quarter or two or longer--or further out than that?

A - Tommy Valenta {BIO 1437548 <GO>}

Well I think it's probably going to be down a little bit. We had--as I mentioned, we had--once a year we have a renewal of participation in our--what we call our financial security plan, which is a non-qualified contributory defined benefit plan. And on January 1, whenever everybody who has increases in pay and that kind of stuff, re-ups for additional coverage, it increases the liability of the company. And so, on January 1, we booked that liability. And so, that was about $1 million. And there were some other things.

We're nearing the end of our fiscal year. So we--as we do that, we start to incur more and more audit fees. And so, we just had record sales in the quarter. And so, our bad debt, which is only a calculation from Black Shoals, that estimates where our bad debt reserves should be, that was higher than normal. So there were several things that contributed to that. Some of them will not be repeated.

Q - Timothy Hayes {BIO 3823493 <GO>}

Okay. Then, in your guidance for Q4, the EPS guidance of $1.35, I'm just clarifying your assumption on metal margin. You'd be looking for a slight improvement in metal margin Q3 to Q4. Is that correct?

A - Tommy Valenta {BIO 1437548 <GO>}

Yes, yes.

Q - Timothy Hayes {BIO 3823493 <GO>}

All right. Then, the final question is in your published prices for structural products, the published price looks like it peaked in December and it's come down maybe $30, $40 a ton through your April pricing letter. I'm a little surprised; with the strength in the international markets and the strength here in the U.S. for non-res; why you had to give up a little bit on the published price. If you could talk to that. I guess my interpretation of that is a very strong market in the U.S. that is maybe a notch or two softer than what it was three or four months ago. Is that the right way of looking at it, or could you add some color to that?

A - Tommy Valenta {BIO 1437548 <GO>}

When you say published price, are you talking--you're leaving out the surcharge, correct?

Q - Timothy Hayes {BIO 3823493 <GO>}

Correct.

A - Tommy Valenta {BIO 1437548 <GO>}

Okay. When we look at the pricing, we're going to put the surcharge in there, whatever the surcharge is. Then, we'll adjust the published price based on the market conditions, where we are internationally. And to try to maintain a balance in the marketplace. And that's exactly what we did this go-around. So I'd say internationally we're right there where we need to be. And the transaction price--it moved. Let's see, it's going to be $75, almost $100 higher. And that's the end game, what is the transaction price changing by. So it's gone up $100 in the last three months. Now, it was in the surcharge. But it was still the transaction price went up.

Q - Timothy Hayes {BIO 3823493 <GO>}

Right. Okay. Thank you.

A - Tommy Valenta {BIO 1437548 <GO>}

Thanks, Tim.

Operator

Your next question comes from the line of Scott Moore of Cornett Sear Capital Management. Please proceed.

Q - Scott Moore {BIO 17892927 <GO>}

Hi, guys. Great quarter.

A - Tommy Valenta {BIO 1437548 <GO>}

Thank you.

Q - Scott Moore {BIO 17892927 <GO>}

I wanted to touch a little bit more on the talk about your plant being included in the Barnett Shale. How much acreage do you have at that plant?

A - Tommy Valenta {BIO 1437548 <GO>}

We have about 700 net acres.

Q - Scott Moore {BIO 17892927 <GO>}

700 net acres. Okay. And--.

A - Tommy Valenta {BIO 1437548 <GO>}

--We actually own more than that. But that's the number of net acres that we calculated for our potential reserve.

Q - Scott Moore {BIO 17892927 <GO>}

Okay. And who is the contract with? Can you divulge that?

A - Tommy Valenta {BIO 1437548 <GO>}

It's with EOG.

Q - Scott Moore {BIO 17892927 <GO>}

Okay. And as far as where you're at, are there producing hydrocarbons in that area? I mean, I know the Barnett Shale as a whole has produced a lot of natural gas over the last number of years. But are you guys kind of on the--an extension of that, where gas hasn't been found yet, or can you give me some more color on that?

A - Tommy Valenta {BIO 1437548 <GO>}

When you look out our back door, I can see three wells being drilled right now. And I don't know how many have been completed. Not being a geologist, I'm not even going to attempt to make an estimate. But I'd have to say it's got to be around here close.

Q - Scott Moore {BIO 17892927 <GO>}

Okay. Great. So there are producing wells there?

A - Tommy Valenta {BIO 1437548 <GO>}

Yes.

Q - Scott Moore {BIO 17892927 <GO>}

Okay. So I think that's it for me. I know that's kind of off the subject of your core business. But I appreciate the help.

A - Tommy Valenta {BIO 1437548 <GO>}

Thank you. No problem, Scott.

A - Celtyn Hughes

Thank you, Scott.

Q - Scott Moore {BIO 17892927 <GO>}

Thank you, guys.

A - Tommy Valenta {BIO 1437548 <GO>}

Have a good day.

Q - Scott Moore {BIO 17892927 <GO>}

You, too.

A - Tommy Valenta {BIO 1437548 <GO>}

Thank you.

Operator

Your next question comes from the line of Dan Wimsatt of AAD Capital. Please proceed.

Q - Dan Wimsatt {BIO 17213341 <GO>}

Good morning.

A - Tommy Valenta {BIO 1437548 <GO>}

Good morning.

Q - Dan Wimsatt {BIO 17213341 <GO>}

Two or three questions, please. I think you mentioned earlier; in the assumption for the $1.35 for next quarter; utilization. Is that 93%--is that what you're thinking?

A - Tommy Valenta {BIO 1437548 <GO>}

Yes.

Q - Dan Wimsatt {BIO 17213341 <GO>}

And just briefly, can you educate me--and I'm sorry for the ignorance. But in terms of seasonal utilization going up or going down, can you give me a sense for what is the--how full can these things run? What is maximum capacity and can you talk about the 22, 23 million in CapEx that you've talked about for the year? Is all of that maintenance? And is that the kind of number going forward as it relates to your assets?

A - Tommy Valenta {BIO 1437548 <GO>}

Well as far as the production capacity, I mean, that is really a function of what products you're rolling. Because you may have 20-pound a foot products or you may 120-pound a foot products. And so, one rolls much more--many more tons in an hour of rolling than the other. So it really depends on your roll schedule. And if you were rolling nothing but the heavyweight stuff, you would exceed your capacity. It's just that variable.

And as far as CapEx, most of our CapEx projects are growth projects internally. They are driven by our work force who comes up with great ideas of how to reduce our power costs or how to reduce our maintenance costs. Most of those things have an attractive return to them. Most of our maintenance CapEx is really done during these little mini shutdowns that we do. Because we rebuild our facilities continually. I don't know whether I covered all of your questions. But did that give--?

Q - Dan Wimsatt {BIO 17213341 <GO>}

--No. That's helpful. Then, just one follow-up on the strong U.S. environment right now. Just this-- the information getting back from the service centers on the end markets. Are there verticals in particular that are continuing to lead the charge? Where are you seeing particular strength in the end markets? Then, conversely, on a relative basis, if there were pockets of weakness, what end markets or what geographies would you say that's coming from?

A - Tommy Valenta {BIO 1437548 <GO>}

Well on the market, the industrial side is the strongest side right now. Non-residential is still strong in areas. You still see it in schools and hospitals. If you take office buildings, they're still lagging behind. We still have about a 13% nationwide vacancy rate. So that's--if that follows trends in the past, that's a matter of a year or so coming up on the building side. As far as what regions of the country, I really don't have that in front of me. They're all pretty equal.

Q - Dan Wimsatt {BIO 17213341 <GO>}

Okay. Great. Thank you.

A - Tommy Valenta {BIO 1437548 <GO>}

Thank you, Dan.

Operator

(Operator Instructions). Your next question is a follow-up question from the line of Michelle Appelbaum of Michelle Appelbaum Research. Please proceed.

Q - Michelle Appelbaum

Hi. Speaking about inventories, I know the service centers aren't the whole story. But they did show a pickup in beam inventories in the month. Month's supply also rose. I was just curious, shipments were up about 4% from last year. But just wondering if you have any concern about building inventories at the service centers.

A - Tommy Valenta {BIO 1437548 <GO>}

Right now, Michelle, we don't. I mean, service centers, they did grow a little bit in January. But we had some pretty rough weather on the East Coast that hampered the service center shipments. And again, we have to remember, the mills have extended their rolling schedules over the past year. And that does force the service centers to carry more inventory to cover that timeframe.

Q - Michelle Appelbaum

Okay. So you just think it's a response to allocation?

A - Tommy Valenta {BIO 1437548 <GO>}

Yes.

Q - Michelle Appelbaum

Okay. Thanks.

A - Tommy Valenta {BIO 1437548 <GO>}

Thank you, Michelle.

A - Celtyn Hughes

Thank you.

Operator

There are no additional questions at this time. I'd like to hand the call back over to Cary Baetz for closing remarks.

A - Cary Baetz {BIO 7384900 <GO>}

Thank you, James. And thank you, everybody, for joining us on this call. And we look forward to speaking to you in July at our fiscal year-end 2007 conference call. With that, have a good week and we'll talk to everybody later. Bye-bye.

Operator

Thank you for your participation in today's conference. This concludes the presentation and you may now disconnect. Good day.