# RUSSEL METALS INC.
# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2017

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") of Russel Metals Inc. and its subsidiaries provides information to assist readers of, and should be read in conjunction with, the condensed consolidated financial statements for the three months ended March 31, 2017, including the notes thereto, and the MD&A and the audited consolidated financial statements for the year ended December 31, 2016, including the notes thereto. In the opinion of management, such condensed consolidated financial statements contain all adjustments necessary for a fair presentation of the results for such periods. The results of operations for the periods shown are not necessarily indicative of what our results will be for the full year. All dollar references in our financial statements and in this report are in Canadian dollars unless otherwise stated.

Additional information related to Russel Metals Inc., including our Annual Information Form, may be obtained from SEDAR at www.sedar.com or on our website at www.russelmetals.com.

Unless otherwise stated, the discussion and analysis contained in this MD&A are as of May 2, 2017.

## FORWARD-LOOKING STATEMENTS

Certain statements contained in this MD&A constitute forward-looking statements or information within the meaning of applicable securities laws, including statements as to our future capital expenditures, our outlook, the availability of future financing and our ability to pay dividends. Forward-looking statements relate to future events or our future performance. All statements, other than statements of historical fact, are forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. Forward-looking statements are necessarily based on estimates and assumptions that, while considered reasonable by us, inherently involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements, including the factors described below.

We are subject to a number of risks and uncertainties which could have a material adverse effect on our future profitability and financial position, including the risks and uncertainties listed below, which are important factors in our business and the metals distribution industry. Such risks and uncertainties include, but are not limited to: the volatility in metal prices; volatility in oil and natural gas prices; cyclicality of the metals industry and the industries that purchase our products; decreased capital and other expenditures in the energy industry; product claims from customers; significant competition that could reduce our market share; the interruption in sources of metals supply; manufacturers selling directly to our customer base; material substitution; credit risk of our customers; lack of credit availability; change in our credit ratings; currency exchange risk; restrictive debt covenants; non-cash asset impairments; the unexpected loss of key individuals; decentralized operating structure; the availability of future acquisitions and their integration; the failure of our key computer-based systems, including our enterprise resource and planning systems; failure to renegotiate any of our collective agreements and work stoppages; litigious business environment; environmental liabilities; environmental concerns or changes in government regulations; legislation on carbon emissions; workplace health and safety laws and regulations; significant changes in laws and governmental regulations; fluctuation of our common share price; dilution; and variability of dividends.

While we believe that the expectations reflected in our forward-looking statements are reasonable, no assurance can be given that these expectations will prove to be correct, and our forward-looking statements included in this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A and, except as required by law, we do not assume any obligation to update our forward-looking statements. Our actual results could differ materially from those anticipated in our forward-looking statements including as a result of the risk factors described above and under the heading "Risk" later in this MD&A, and under the heading "Risk Management and Risks Affecting Our Business" in our most recent Annual Information Form and as otherwise disclosed in our filings with securities regulatory authorities which are available on SEDAR at www.sedar.com.

## NON-GAAP MEASURES

This MD&A includes a number of measures that are not prescribed by Canadian generally accepted accounting principles ("GAAP") and as such may not be comparable to similar measures presented by other companies. We believe these measures are commonly employed to measure performance in our industry and are used by analysts, investors, lenders and other interested parties to evaluate financial performance and our ability to incur and service debt to support our business activities. The measures we use are specifically defined where they are first used in this report.

While we believe that non-GAAP measures are helpful supplemental information, they should not be considered in isolation as an alternative to net income, cash flows generated by operating, investing or financing activities, or other financial statement data presented in accordance with GAAP.

## OVERVIEW

We are one of the largest metals distribution companies in North America. We conduct business primarily in three metals distribution segments: metals service centers, energy products, and steel distributors.

Our basic earnings per share increased to $0.48 for the quarter ended March 31, 2017 compared to $0.13 for the first quarter of 2016.

Steel prices increased in the quarter which led to stronger margins in our metals service centers and our steel distributors segments. In addition to the rise in selling prices, shipments increased in metals service centers both of which resulted in stronger operating profits. Stable oil and gas prices led to improved demand which resulted in an increase in steel prices and improved operating profits in our energy products segment.

## RESULTS OF OPERATIONS

The following table provides operating profits before interest and income taxes. The corporate expenses included are not allocated to specific operating segments. Gross margins (revenue minus cost of sales) as a percentage of revenues for the operating segments are also shown below. The table shows the segments as they are reported to management and are consistent with the segment reporting in our condensed consolidated financial statements.

| *(in millions, except percentages)* | Quarters Ended March 31 **2017** | 2016 | change as a % of 2016 |
|---|---|---|---|
| ***Segment Revenues*** | | | |
| Metals service centers | **$ 386.4** | $ 341.1 | 13% |
| Energy products | **339.1** | 248.4 | 37% |
| Steel distributors | **77.6** | 72.5 | 7% |
| Other | **0.4** | 0.1 | |
| | **$ 803.5** | $ 662.1 | 21% |
| ***Segment Operating Profits*** | | | |
| Metals service centers | **$ 21.8** | $ 9.6 | 127% |
| Energy products | **23.6** | 6.8 | 247% |
| Steel distributors | **8.4** | 7.1 | 18% |
| Corporate expenses | **(5.1)** | (5.9) | 14% |
| Other | **(0.8)** | (1.0) | |
| Operating profits | **$ 47.9** | $ 16.6 | 189% |
| ***Segment Gross Margin as a % of Revenues*** | | | |
| Metals service centers | **22.4%** | 20.7% | |
| Energy products | **17.3%** | 16.6% | |
| Steel distributors | **21.6%** | 20.6% | |
| Total operations | **20.2%** | 19.2% | |
| ***Segment Operating Profit as a % of Revenues*** | | | |
| Metals service centers | **5.6%** | 2.8% | |
| Energy products | **7.0%** | 2.7% | |
| Steel distributors | **10.8%** | 9.8% | |
| Total operations | **6.0%** | 2.5% | |

Results of our U.S. operations reported for the three months ended March 31, 2017 were converted at $1.3231 per US$1 compared to $1.3748 per US$1 for the three months ended March 31, 2016. The strengthening of the Canadian dollar in 2017 versus 2016 decreased revenues, expenses and profits for our U.S. operations when translated to Canadian dollars. Revenues from our U.S. operations represented 31% of our total revenues. The exchange rate at March 31, 2017 used to translate the balance sheet was $1.3299 per US$1 versus $1.3427 per US$1 at December 31, 2016.

## QUARTERLY FINANCIAL HIGHLIGHTS

| *(for the quarters ended)* | **Mar 31 2017** | Dec 31 2016 | Sep 30 2016 | Jun 30 2016 | Mar 31 2016 | Dec 31 2015 | Sep 30 2015 | Jun 30 2015 |
|---|---|---|---|---|---|---|---|---|
| Revenues *($ millions)* | **$ 804** | $ 654 | $ 639 | $ 624 | $ 662 | $ 673 | $ 773 | $ 761 |
| Operating profits *($ millions)* | **48** | 17 | 28 | 30 | 17 | (29) | 19 | 31 |
| Net earnings *($ millions)* | **30** | 23 | 16 | 16 | 8 | (135) | 13 | 16 |
| Basic earnings per share *($)* | **0.48** | 0.37 | 0.26 | 0.27 | 0.13 | (2.19) | 0.21 | 0.27 |

## METALS SERVICE CENTERS

### *a) Description of operations*

We provide processing and distribution services to a broad base of approximately 43,000 end users through a network of 50 Canadian locations and 14 U.S. locations. Our metals service centers carry a broad line of products in a wide range of sizes, shapes and specifications, including carbon hot rolled and cold finished steel, pipe and tubular products, stainless steel and aluminum. We purchase these products primarily from steel producers in North America and process and package them in accordance with end user specifications. We service all major geographic regions of Canada and the Southeastern and Midwestern regions in the United States. Within Canada, our service centers operate under the names Russel Metals, Métaux Russel, A.J. Forsyth, Acier Leroux, Acier Loubier, Alberta Industrial Metals, B&T Steel, Leroux Steel, Mégantic Métal, Russel Metals Processing, Russel Metals Specialty Products, Métaux Russel Produits Spécialisés, McCabe Steel and York-Ennis. Our U.S. service centers operate under the names Russel Metals Williams Bahcall, JMS Russel Metals, Norton Metals and Baldwin International.

### *b) Factors affecting results*

The following is a general discussion of the significant factors affecting our metals service centers results. More specific information on how these factors impacted the first quarter of 2017 and 2016 is found in the section that follows.

Steel prices fluctuate significantly throughout the steel cycle. Steel prices are influenced by overall international demand, trade sanctions, iron ore prices, scrap steel prices and product availability. Volatile metal prices cause fluctuations in our operating results. Steel price increases were announced in late 2016 and during the first quarter of 2017.

Supply side management, practiced by steel producers in North America, and international supply and demand, which impacts steel imports, affects product availability. Trade sanctions are initiated either by steel mills or by North American government agencies. During the first quarter of 2017, the U.S. Department of Commerce issued an affirmative final determination on cut-to-length plate from various countries resulting in the assessment of dumping margins. Also during the 2017 first quarter, the Canadian International Trade Tribunal issued a final dumping determination on rebar from various countries. All of these rulings were positive for North American steel mills and steel prices.

The 2016 final affirmation ruling in U.S. trade cases involving hot rolled coil, cold rolled coil and corrosion resistant coil continue to be positive in supporting North American steel prices. An investigation of the circumvention of cold rolled and corrosion resistant coil from Vietnam which were converted from hot rolled steel produced in China is ongoing and a ruling is not expected until the second half of 2017. In April 2017, the Department of Commerce self-initiated an investigation under section 232 of the Trade Expansion Act of 1962 to determine whether imports of foreign-made steel were harming U.S. national security.

Our operating results are affected by the inherent risk of the cyclicality of the metals industry and the industries that purchase our products. Demand for our products is significantly affected by economic cycles. Revenues and operating profits fluctuate with the level of general business activity in the markets served. We are most impacted by the manufacturing, resource (including oil and gas), and construction segments of the North American economy.

Canadian service centers, which represent the majority of our metals service center operations, have operations in all regions of Canada and are affected by general regional economic conditions. Our large market share and diverse customer base of approximately 26,000 Canadian customers means that our results tend to mirror the performance of the regional economies of Canada. Our U.S. operations, which have approximately 17,000 customers, are also impacted by the local economic conditions in the regions that they serve.

Results of our Canadian operations can be affected by the U.S. dollar exchange rate since some products are sourced outside of Canada and are priced in U.S. dollars. Movement in the Canadian dollar has a short-term impact on inventory prices.

### c) Metals service centers segment results -- Three Months Ended March 31, 2017 compared to March 31, 2016

Revenues for the three months ended March 31, 2017 increased 13% to $386 million compared to the same period in 2016. Tons shipped in the metals service centers segment in the first quarter of 2017 were approximately 2% higher than the first quarter of 2016 and 11% higher than the fourth quarter of 2016. We experienced volume increases in the 2017 first quarter in all regions except British Columbia and Atlantic. The average selling price improved 11% compared to the same quarter in 2016 and was 6% higher than the 2016 fourth quarter.

Gross margin as a percentage of revenues of 22.4% was higher than the same quarter last year at 20.7%, and 2016 gross margin of 21.6%. The increased gross margin percentage resulted from the rising price environment and our continued growth in value-added processing.

Operating expenses as a percentage of revenues of 16.8% in the 2017 first quarter were down from 17.9% in the 2016 first quarter.

Metals service centers operating profits for the three months ended March 31, 2017 of $22 million were 127% higher than the $10 million reported for the same period in 2016 due to increased revenues and improved gross margins.

## ENERGY PRODUCTS

### a) Description of operations

We distribute oil country tubular goods (OCTG), line pipe, tubes, valves and fittings, primarily to the energy industry in Western Canada and the United States. A significant portion of our business units are clustered in Alberta and Saskatchewan, Canada, and in the U.S., in Colorado and Texas. A large portion of our inventories are located in third party yards ready for distribution to customers throughout North America. In addition, we operate from 49 Canadian and 19 U.S. facilities mainly to support our valve and fitting operations. The majority of these facilities are oil field stores which form the Apex Distribution network. We purchase our products from the pipe division of North American steel mills, independent manufacturers of pipe, valves and fittings, international steel mills and other distributors. Our energy products segment operates under the names Apex Distribution, Apex Monarch, Apex Remington, Apex Western Fiberglass, Comco Pipe and Supply Company, Fedmet Tubulars, Triumph Tubular & Supply, Pioneer Pipe and Spartan Energy Tubulars.

### b) Factors affecting results

The following is a general discussion of the factors affecting our energy products segment operations. More specific information on how these factors impacted the first quarter of 2017 and 2016 is found in the section that follows.

The price of natural gas and oil can impact rig count and drilling activities, which affects demand for our products. Oil and gas prices, which had declined since 2014, stabilized in 2016. This severe drop and continued low level of the price of oil caused a reduction in capital spending projects and rig activity of our energy product customers during 2015 and 2016. Rig activity has increased in the first quarter of 2017 in both Canada and the U.S. which has benefited our energy products segment.

Prices for pipe products are influenced by overall demand, trade sanctions, product availability and metal prices. Trade sanctions are initiated either by steel mills or by government agencies in North America. Both the Canadian and U.S. governments have imposed duties on certain Chinese pipe, which remain in effect and reduce imports of these products. The U.S. government initiated reviews in 2015 and 2016 on pipe from a number of other countries. This continued into the 2017 first quarter with the U.S. Department of Commerce completing an administrative review of OCTG from South Korea. Due to the overstocked inventory position of the industry and low demand, prices remained under pressure for most of 2016 despite the trade sanctions put in place. By the end of 2016, this inventory overhang was reduced and as demand increased the product margins improved due to shortages of certain products. Prices of valves and fittings are not as sensitive to steel price fluctuations because they are highly engineered value-added products.

Drilling activity in Western Canada historically peaks during the period from October to March, which means that the first and fourth quarters tend to be stronger in this segment.

### c) *Energy products segment results -- Three Months Ended March 31, 2017 compared to March 31, 2016*

Revenues in our energy products segment increased 37% to $339 million for the first quarter of 2017 compared to the same period of 2016 due to stronger activity at all operations in the segment. Improved selling prices and demand led to increased revenues.

Gross margin as a percentage of revenues for the three months ended March 31, 2017 was 17.3% compared to 16.6% in the same period in 2016. All of our energy products operations experienced stronger demand. A reduction of excess inventory in the industry as well as an increase in the price of pipe resulted in higher margins.

Operating expenses as a percentage of revenues of 10.3% in the quarter ending March 31, 2017 was lower than the 13.9% in the same quarter last year as our 2016 cost cutting initiatives resulted in a strong improvement in operating costs as a percentage of revenues.

This segment generated an operating profit of $24 million for the three months ended March 31, 2017, over three times higher than operating profit of $7 million for the same period in 2016.

## STEEL DISTRIBUTORS

### a) *Description of operations*

Our steel distributors act as master distributors selling steel in large volumes to other steel service centers and equipment manufacturers mainly on an "as is" basis. Our U.S. operation has a cut-to-length facility operating under the name Arrow Steel, located in Houston, Texas where it processes coil for its customers. Our steel distributors source their steel both domestically and off shore.

The main steel products sourced by this segment are structural beam, plate, coils, pipe and tubing; however, product volumes vary based on the economy and trade actions in North America. Our steel distributors operate under the names Wirth Steel and Sunbelt Group. Arrow Steel processes and levels coil products.

### b) *Factors affecting results*

The following is a general discussion of the significant factors affecting our steel distributors. More specific information on how these factors impacted the first quarter of 2017 and 2016 is found in the section that follows.

Steel prices are influenced by overall demand, trade sanctions and product availability both domestically and worldwide. Trade sanctions are initiated either by steel mills or government agencies in North America. Trade actions currently exist on plate and pipe from specified countries. Additional duties have been levied by the U.S. government since 2016.

Demand for steel that is sourced off shore fluctuates significantly and is mainly driven by price and product availability in North America. Our steel distributors have a significant number of customers who buy product from them on a periodic basis which can result in large fluctuations in revenues reported from period to period.

### c) *Steel distributors segment results -- Three Months Ended March 31, 2017 compared to March 31, 2016*

Revenues for steel distributors increased 7% to $78 million for the three months ended March 31, 2017 compared to the same period in 2016 mainly due to higher pricing.

Gross margin as a percentage of revenues was 21.6% for the three months ended March 31, 2017 compared to 20.6% for the three months ended March 31, 2016. Steel price increases resulted in higher gross margin percentage for the three months ended March 31, 2017.

Operating expenses as a percentage of revenues of 10.8% for the first quarter of 2017 was consistent with the 2016 first quarter.

Operating profits for the three months ended March 31, 2017 were $8 million compared to $7 million for the period ended March 31, 2016 as a result of higher gross margins.

### *CORPORATE EXPENSES -- Three Months Ended March 31, 2017 compared to March 31, 2016*

Corporate expenses were $5 million for the three months ended March 31, 2017 compared to $6 million in the first quarter of 2016. The $1 million decrease in corporate expense was due to lower share-based compensation in the first quarter of 2017. In the 2017 first quarter our share price increased by 2% compared to an increase of 23% in the 2016 first quarter.

### *CONSOLIDATED RESULTS -- Three Months Ended March 31, 2017 compared to March 31, 2016*

Operating profits were $48 million for the first quarter of 2017 compared to $17 million for the first quarter of 2016 due to stronger operating profits in all three business segments and lower corporate expenses.

### INTEREST EXPENSE AND INCOME

Net interest expense was $5 million in the 2017 and 2016 first quarter.

### INCOME TAXES

We recorded a provision for income taxes of $13 million for the first quarter of 2017 compared to $3 million for the first quarter of 2016. Our effective income tax rate for the three months ended March 31, 2017 was 30.9% compared to 30.4% for the three months ended March 31, 2016.

### NET EARNINGS

Net earnings for the first quarter of 2017 were $30 million compared to $8 million for the first quarter of 2016. Basic earnings per share for the first quarter of 2017 were $0.48 per share compared to $0.13 per share for the first quarter of 2016.

### SHARES OUTSTANDING AND DIVIDENDS

The weighted average number of common shares outstanding for the first quarter of 2017 was 61,754,827 compared to 61,702,560 for the first quarter of 2016. Common shares outstanding at March 31, 2017 and May 2, 2017 were 61,792,194.

We paid common share dividends of $23 million or $0.38 per share in the first quarter of 2017 and 2016.

We have $300 million 6.0% Senior Notes due April 19, 2022. The indenture for our Senior Notes has restrictions related to the payment of quarterly dividends in excess of $0.35 per share. We currently have a basket of approximately $231 million available for restricted payments, which is adjusted for 50% of our net earnings or losses on a quarterly basis. This basket is available for dividend payments greater than $0.35 per share which, at the current dividend rate, utilizes approximately $7 million per annum of the restricted payment basket.

Under our syndicated bank facility, the payment of dividends is subject to excess borrowing base availability of not less than four times the declared dividend. We do not believe this requirement will restrict our ability to pay dividends as our borrowing base, which is based on percentages of accounts receivable and inventories, has traditionally been in excess of our borrowings plus four times the current dividend. In addition, if our excess borrowing base were to be below four times our dividend, we believe we would be able to obtain a waiver or finance our short-term cash requirements with alternate financing structures and pay the dividend.

## EBITDA

The following table shows the reconciliation of net earnings to EBITDA:

| *(millions)* | Quarters ended March 31 **2017** | 2016 |
|---|---|---|
| Net earnings | **$ 29.6** | $ 7.8 |
| Provision for income taxes | **13.3** | 3.4 |
| Interest expense, net | **5.0** | 5.4 |
| Earnings before interest and income taxes (EBIT) | **47.9** | 16.6 |
| Depreciation and amortization | **8.5** | 8.9 |
| Earnings before interest, income taxes, depreciation and amortization (EBITDA) | **$ 56.4** | $ 25.5 |

We believe that EBITDA, a non-GAAP measure, may be useful in assessing our operating performance and as an indicator of our ability to service or incur indebtedness, make capital expenditures and finance working capital requirements. The items excluded in determining EBITDA are significant in assessing our operating results and liquidity. Therefore, EBITDA should not be considered in isolation or as an alternative to cash from operating activities or other combined income or cash flow data prepared in accordance with GAAP.

## CAPITAL EXPENDITURES

Capital expenditures were $6 million for the first quarter of 2017 compared to $3 million in the first quarter of 2016. Depreciation expense was $7 million for the first quarter of 2017 and 2016. We expect capital expenditures to approximate depreciation in 2017.

## LIQUIDITY

At March 31, 2017, we had net cash, defined as cash less bank indebtedness, of $90 million compared to net cash of $147 million at December 31, 2016.

We generated $56 million from operations in the first quarter of 2017 and utilized $82 million for working capital, due to increased accounts receivable as a result of higher revenues. We utilized $6 million for capital expenditures and $23 million for dividends to shareholders.

Due to the cyclicality of our business, we experience significant swings in working capital which impact cash flow. Inventory and accounts receivable represent a large percentage of our total assets employed and vary throughout each cycle. Accounts receivable and inventory comprise our largest liquidity risks. The cyclical nature of our business leads to significant price fluctuations that may result in inventory provisions.

Total assets were $1.6 billion at March 31, 2017 and $1.5 billion at December 31, 2016. At March 31, 2017 current assets excluding cash represented 77% of our total assets compared to 75% at December 31, 2016.

Inventory purchases utilized cash of $14 million in the three months ended March 31, 2017. Inventories were reduced in our energy products segment as demand improved and we disposed of slow moving inventory. Inventories represented 39% of our total assets at March 31, 2017 compared to 41% at December 31, 2016.

| *Inventory by Segment (millions)* | **Mar. 31 2017** | Dec. 31 2016 | Sept. 30 2016 | June 30 2016 | Mar. 31 2016 |
|---|---|---|---|---|---|
| Metals service centers | **$ 300** | $ 252 | $ 249 | $ 260 | $ 235 |
| Energy products | **280** | 288 | 302 | 340 | 353 |
| Steel distributors | **61** | 76 | 84 | 81 | 90 |
| Total | **$ 641** | $ 616 | $ 635 | $ 681 | $ 678 |

| *Inventory Turns* *(quarters ended)* | **Mar. 31 2017** | Dec. 31 2016 | Sept. 30 2016 | June 30 2016 | Mar. 31 2016 |
|---|---|---|---|---|---|
| Metals service centers | **3.7** | 4.2 | 4.4 | 4.3 | 4.6 |
| Energy products | **3.8** | 2.9 | 2.4 | 1.7 | 2.3 |
| Steel distributors | **5.4** | 3.5 | 2.8 | 3.3 | 2.5 |
| Total | **3.9** | 3.5 | 3.2 | 2.9 | 3.2 |

At March 31, 2017, our metals service centers had inventory tons 9% higher than at March 31, 2016 as inventory purchases increased to coincide with stronger demand.

Our energy products operations reduced inventory levels during the first quarter of 2017 as improved commercial activity allowed a significant reduction of slow moving inventory. Inventory turns improved significantly due to increased revenues.

Stronger demand at our steel distributors segment, along with shipment delays, caused the operations in this segment to reduce inventory levels. At the end of the 2017 first quarter, letters of credit to support import purchases of inventory were $78 million, almost double the letters of credit at March 31, 2016.

Accounts receivable utilized cash of $108 million in the first quarter of 2017 due to higher revenues in the quarter. Accounts receivable represented 32% of our total assets, excluding cash at March 31, 2017 compared to 27% at December 31, 2016.

During the first quarter of 2017 and 2016 we made income tax payments of $2 million.

The balances disclosed in our consolidated cash flow statements are adjusted to remove the non-cash component related to foreign exchange rate fluctuations impacting inventory, accounts receivable, accounts payable and income tax balances of our U.S. operations.

## FREE CASH FLOW

| *(millions)* | Quarters ended March 31 **2017** | 2016 |
|---|---|---|
| Cash from operating activities before non-cash working capital | **$ 56.3** | $ 24.5 |
| Purchase of property, plant and equipment | **(5.6)** | (3.0) |
| | **$ 50.7** | $ 21.5 |

We believe that free cash flow may be useful in assessing our ability to pay dividends, reduce outstanding debt and fund working capital growth. Free cash flow is a non-GAAP measure regularly used by investors and analysts to evaluate companies.

## DEBT

| *(millions)* | **March 31 2017** | December 31 2016 |
|---|---|---|
| Long-term debt | | |
| 6% $300 million Unsecured Senior Notes due April 19, 2022 | **$ 296** | $ 296 |

## CASH AND BANK CREDIT FACILITY

| *Credit Facility* *(millions)* | **March 31 2017** | December 31 2016 |
|---|---|---|
| Bank loans | **$ (83)** | $ (43) |
| Cash net of outstanding cheques | **173** | 190 |
| Net cash | **90** | 147 |
| Letters of credit | **(78)** | (39) |
| | **$ 12** | $ 108 |
| Facilities | | |
| Borrowings and letters of credit | **$ 350** | $ 350 |
| Letters of credit | **50** | 50 |
| Facilities availability | **$ 400** | $ 400 |
| Available line based on borrowing base | **$ 400** | $ 400 |

We have a credit facility with a syndicate of Canadian and U.S. banks totaling $400 million which expires September 21, 2019. The syndicated facility consists of availability of $350 million under Tranche I to be utilized for borrowings and letters of credit, and $50 million under Tranche II to be utilized only for letters of credit. Letters of credit are issued under Tranche II first and additional needs are issued under Tranche I. The borrowings and letters of credit are available on a revolving basis, up to an amount equal to the sum of specified percentages of our eligible accounts receivable and inventories, to a maximum of $400 million.

As of March 31, 2017, we were entitled to borrow and issue letters of credit totaling $400 million under this facility. At March 31, 2017, we had $83 million in borrowings compared to $43 million at December 31, 2016. We had $78 million in letters of credit at March 31, 2017 compared to $39 million at December 31, 2016.

At March 31, 2017, we were in compliance with all of our financial covenants.

With our cash, cash equivalents and our bank facilities we have access to approximately $401 million of cash based on our March 31, 2017 balances. The use of our bank facilities has been predominantly to fund working capital requirements, acquisitions and trade letters of credit for inventory purchases. These lines may be used to support increased working capital needs when volumes and steel prices increase.

## CONTRACTUAL OBLIGATIONS

As at March 31, 2017, we were contractually obligated to make payments as per the following table:

| | Payments due in | | | | |
|---|---|---|---|---|---|
| *Contractual Obligations* *(millions)* | 2017 | 2018 and 2019 | 2020 and 2021 | 2022 and thereafter | Total |
| Accounts payable | $ 359 | $ - | $ - | $ - | $ 359 |
| Debt | - | - | - | 300 | 300 |
| Long-term debt interest | 18 | 36 | 36 | 10 | 100 |
| Operating leases | 17 | 35 | 22 | 23 | 97 |
| Total | $ 394 | $ 71 | $ 58 | $ 333 | $ 856 |

As part of the purchase consideration for Apex Distribution and Apex Monarch we agreed to pay additional cash consideration during the five years ending 2017 and 2018, respectively, based on earnings before interest and taxes and return on net assets. Based on our assumptions of the expected future activity levels in the areas served by these operations we determined the fair value of these obligations to be zero. Improvements in the markets served may result in other finance expense and possible future contingent consideration payments.

We have obligations related to multiple defined benefit pension plans in Canada, as disclosed in Note 14 of our 2016 consolidated financial statements. During the first quarter of 2017, we contributed $1 million to these plans. We expect to contribute approximately $4 million to these plans during the remainder of the year. The defined benefit obligations reported in the consolidated financial statements use different assumptions than the going concern actuarial valuations prepared for funding. In addition, the actuarial valuations provide a solvency valuation, which is a valuation assuming the plan is wound up at the valuation date. Our reported funding obligations would increase by $6 million on a solvency basis and thus additional funding could be required based on solvency if the plans were wound up. We estimate the impact of a 0.25% change in the discount rate on the solvency obligation would be approximately $5 million.

We have disclosed our obligations related to environmental litigation, regulatory actions and remediation in our Annual Information Form under the heading "Environmental Regulation". These obligations, which are not material, relate to previously divested or discontinued operations and do not relate to the metals distribution business.

## OFF-BALANCE SHEET ARRANGEMENTS

Our off-balance sheet arrangements consist of the letters of credit disclosed in the bank credit facilities table and operating lease obligations disclosed in the contractual obligations table.

## ACCOUNTING ESTIMATES

The preparation of our consolidated financial statements requires management to make estimates and judgements that affect the reported amounts. On an ongoing basis, we evaluate our estimates, including those related to bad debts, inventory valuation, useful lives of fixed assets, asset impairment, fair values, income taxes, pensions and benefits obligations, guarantees, decommissioning liabilities, contingencies, contingent consideration, litigation and assigned values on net assets acquired. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Our most significant assets are accounts receivable and inventories.

*Accounts Receivable*

An allowance for doubtful accounts is maintained for estimated losses resulting from the inability of our customers to make required payments. Assessments are based on aging of receivables, legal issues (bankruptcy status), past collection experience, current financials, credit agency reports and the experience of our credit personnel. Accounts receivable which we determine to be uncollectible are reserved in the period in which the determination is made. If the financial condition of our customers was to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Our reserve for bad debts at March 31, 2017 was approximately $1 million lower than our reserve at December 31, 2016. Bad debt expense for the first quarter of 2017 as a percentage of revenues was less than 1% and approximates that of 2016.

*Inventories*

We review our inventories to ensure that the cost of inventories is not in excess of its estimated net realizable value and for obsolete and slow moving product. Inventory reserves or write-downs are recorded when cost exceeds the estimated selling price less cost to sell and when product is determined to be slow moving or obsolete. The inventory reserve level at March 31, 2017 was $3 million lower than the level at December 31, 2016 due to a stronger pricing environment and the sale of slow moving product in the quarter.

Other areas involving significant estimates and judgements include:

*Goodwill Impairment*

The determination of whether goodwill and intangibles are impaired requires the estimation of future cash flows and an appropriate discount rate to determine value in use. An impairment occurs when the book value of the assets associated with a particular cash generating unit is greater than the value in use. The assessment of future cash flows and a discount rate requires significant judgment.

*Income Taxes*
We believe that we have adequately provided for income taxes based on the information that is currently available. The calculation of income taxes in many cases requires significant judgement in interpreting tax rules and regulations, which are constantly changing. Our tax filings are also subject to audits, which could materially change the amount of current and future income tax assets and liabilities. Any change would be recorded as a charge or reduction in income tax expense.

*Business Combinations*
For each acquisition we review the fair value of assets acquired. Where we deem it appropriate, we hire outside business valuators to assist in the assessment of the fair value of property, plant, equipment, intangibles and contingent consideration of acquired businesses. The assessment of fair values for contingent consideration is completed quarterly and requires significant judgement.

*Contingent Liabilities*
Provisions for claims and potential claims are determined on a case by case basis. We recognize contingent loss provisions when it is determined that a loss is probable and when we are able to reasonably estimate the obligation. This determination takes significant judgement and actual cash outflows might be materially different from estimates. In addition, we may receive claims in the future that could have a material impact on our financial results.

The Company and certain of its subsidiaries have been named defendants in a number of legal actions. Although the outcome of these legal actions cannot be determined, management intends to defend all such legal actions and has recorded provisions, as required, based on its best estimate of the potential losses. In the opinion of management, the resolution of these legal actions is not expected to have a material adverse effect on our financial position, cash flows or operations.

During the 2017 first quarter we settled and paid an energy products customer claim relating to product that was distributed from 2010 to 2012. We had previously provided for this claim.

*Employee Benefit Plans*
At least every three years, our actuaries perform a valuation for each defined benefit plan to determine the actuarial present value of the benefits. The valuation uses management's assumptions for the interest rate, rate of compensation increase, rate of increase in government benefits and expected average remaining years of service of employees. While we believe that these assumptions are reasonable, differences in actual results or changes in assumptions could materially affect employee benefit obligations and future net benefit plan cost. We account for differences between actual and assumed results by recognizing differences in benefit obligations and plan performance immediately in other comprehensive income.

We had approximately $132 million in plan assets at March 31, 2017, which is an increase of approximately $3 million from December 31, 2016. The discount rate used on the employee benefit plan obligation for the quarter ended March 31, 2017 was 3.75% which is consistent with the discount rate at December 31, 2016.

## CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management on a timely basis so that appropriate decisions can be made regarding public disclosure.

The purpose of internal controls over financial reporting as defined by the Canadian Securities Administrators is to provide reasonable assurance that:

(i) financial statements prepared for external purposes are in accordance with the Company's generally accepted accounting principles,
(ii) transactions are recorded as necessary to permit the preparation of financial statements, and records are maintained in reasonable detail,

(iii) receipts and expenditures of the Company are made only in accordance with authorizations of the Company's management and directors, and
(iv) unauthorized acquisitions, uses or dispositions of the Company's assets that could have a material effect on the financial statements will be prevented or detected in order to prevent material error in financial statements.

The Chief Executive Officer and the Executive Vice President and Chief Financial Officer have caused management and other employees to design and document our disclosure controls and procedures and our internal controls over financial reporting. The design of internal controls was completed using the framework and criteria established in "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

No changes were made in our disclosure controls and procedures of our internal controls over financial reporting during the first quarter of 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## VISION AND STRATEGY

The metals distribution business is a segment of a mature, cyclical industry. We strive to deal with the cyclical nature of the business by operating with the lowest possible net assets throughout the course of a cycle. This intensive asset management reduces borrowings and therefore interest expense in declining periods in the economic cycle. This in turn creates higher, more stable returns on net assets over a cycle. Our conservative management approach creates relatively stronger trough earnings but could cause potential peak earnings to be somewhat muted. Management believes that this strategy will result in higher profits throughout a cycle and we will have average earnings over the cycle in the top deciles of the industry.

We have significant investments in business units that service the oil and gas industry. We endeavour to manage the inventories and costs in these businesses to enable us to react to the variability of oil and gas prices.

Growth from selective acquisitions is also part of our strategy. We focus on investment opportunities in metals businesses that have strong market niches or provide mass to our existing operations. New acquisitions could be either major stand-alone operations or ones that complement our existing operations. We made small acquisitions in both 2015 and 2016 and we continue to review opportunities for acquisitions.

We believe that the steel-based pricing cycle will continue to be short and volatile, and a management structure and philosophy that allows the fastest reaction to changes that affect the industry will be the most successful. We will continue to invest in our business systems to enable faster reaction times to changing business conditions.

## RISK

The timing and extent of future price changes from steel producers and their impact on us cannot be predicted with any certainty due to the inherent cyclical nature of the steel industry, modest capacity utilization rates for North American steel producers and historically high import levels.

A large portion of our revenues are dependent on the oil and gas industry whose activity fluctuates with oil and gas prices. Our acquisitions between 2012 and 2015 of oil field store operations increased our exposure to the oil and gas industry; however, they have provided a more stable stream of earnings for the energy products segment.

We have implemented an enterprise risk management program. The enterprise risk management program and a summary of the risks affecting our business is described under the heading "Risk Management and Risks Affecting Our Business" in our most recent Annual Information Form, which section is incorporated by reference in this "Risk" section of our MD&A.

## OUTLOOK

Since the end of 2016, steel prices have recovered and stabilized. This led to improved margins in the 2017 first quarter for metals service centers and steel distributors. We believe that the stable pricing environment will continue in the second quarter resulting in strong operating profits.

In the energy products segment we expect second quarter results to be stronger than last year due to increased demand. Our Canadian operations are expected to be lower than the first quarter due to spring breakup resulting in lower Canadian drilling activity.