

# SMU Community Chat

July 14, 2021

Starting at 11 AM Eastern

Michael Cowden, Steel Market Update

Dan Sullivan, Montrose Advisors



[SteelMarketUpdate.com/Blog/SMU-Community-Chat-Webinars](https://SteelMarketUpdate.com/Blog/SMU-Community-Chat-Webinars)

# Steel Market Update



SMU Newsletter developed for active buyers & sellers of flat rolled steel.

**Prices – Momentum – Trends – Analysis – with a guarantee**

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# 2021 Steel Market Update Events

| Date          | Conference        | Status  | Venue                                   |
|---------------|-------------------|---------|---|
| July 20-21    | Steel 101         | Virtual | Online                                  |
| August 3-4    | Steel Hedging 201 | Virtual | Online                                  |
| August 23-25  | SMU Steel Summit  | Live    | Georgia International Convention Center |
| September TBD | Steel 201         | Virtual | Online                                  |

If you would like more information about any of our workshops, you may visit [SteelMarketUpdate.com/Events](https://SteelMarketUpdate.com/Events) or e-mail our team at [Events@SteelMarketUpdate.com](mailto:Events@SteelMarketUpdate.com)

# Nominations Due on Friday!



#SMUSteel

Time is running out  
Nominations  
close this Friday, 16 July

Recognize  
talent

Celebrate  
excellence

Shine a light on the hard work of the young people in your organization,  
and celebrate with the greater steel industry

[www.smusteelsummit.com](http://www.smusteelsummit.com)



Steel 101 Workshop, Severstal Dearborn 2012

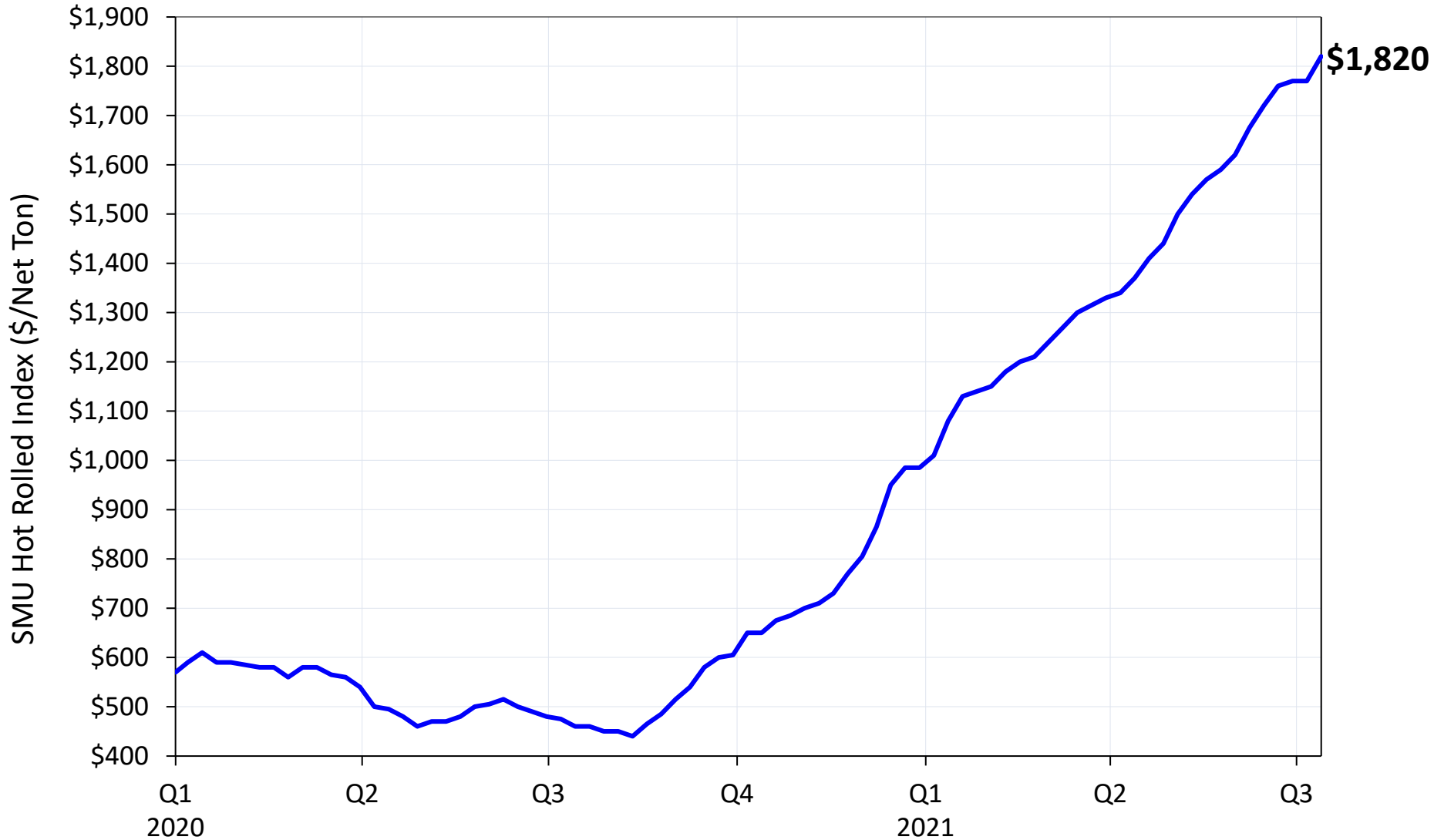
Our goal is to provide quality information to the flat rolled steel industry.

We invite over 500 companies to participate in our surveys.

Normal response rate is 100-150 individuals on any one survey.

All responses are kept confidential and are never attributed to the individual or company responding.

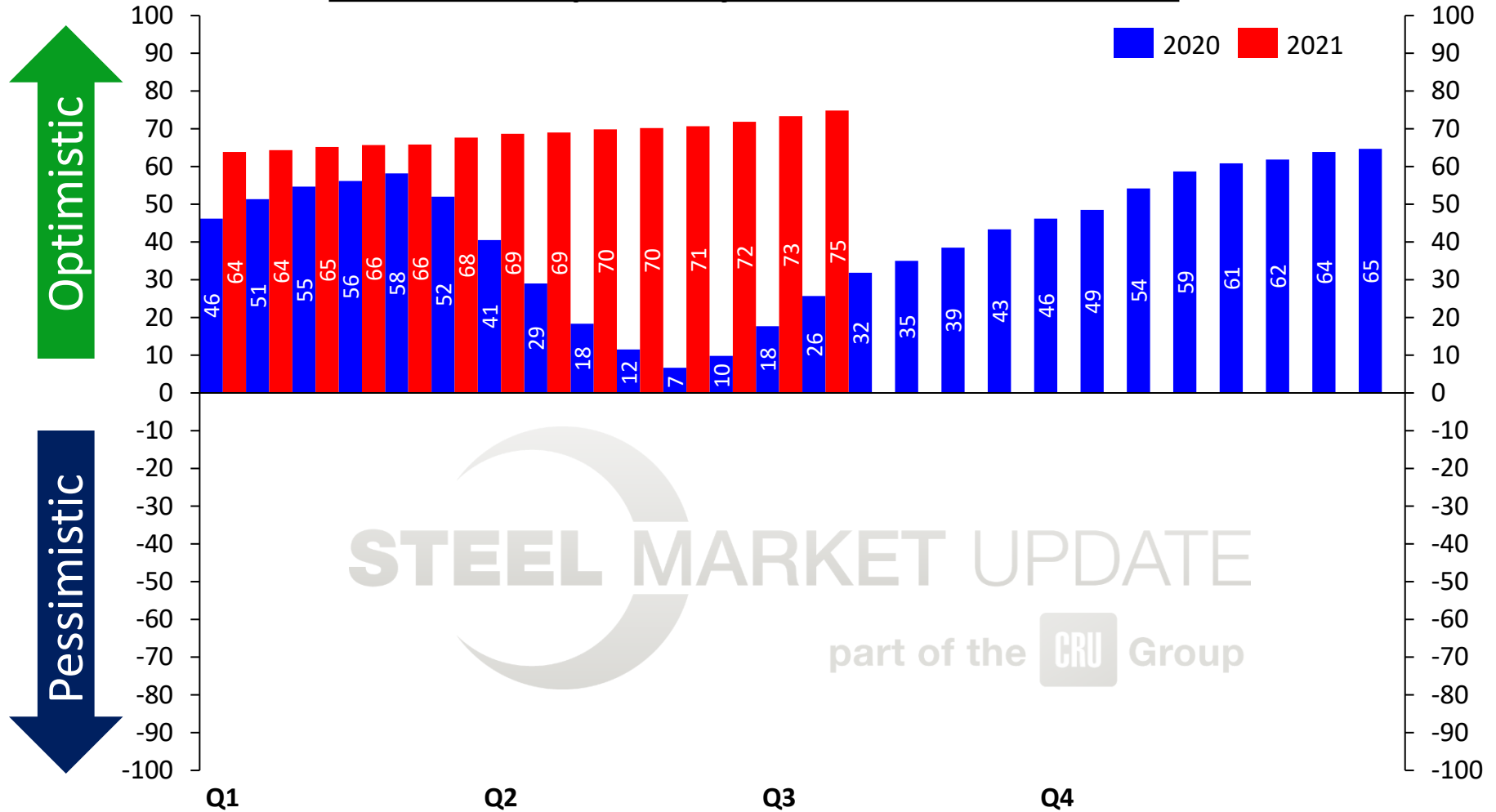
# SMU Hot Rolled Price Average



# SMU Buyers Sentiment Index

Three Month Moving Average at +74.83

## Steel Market Update Buyers Sentiment Index 3MMA

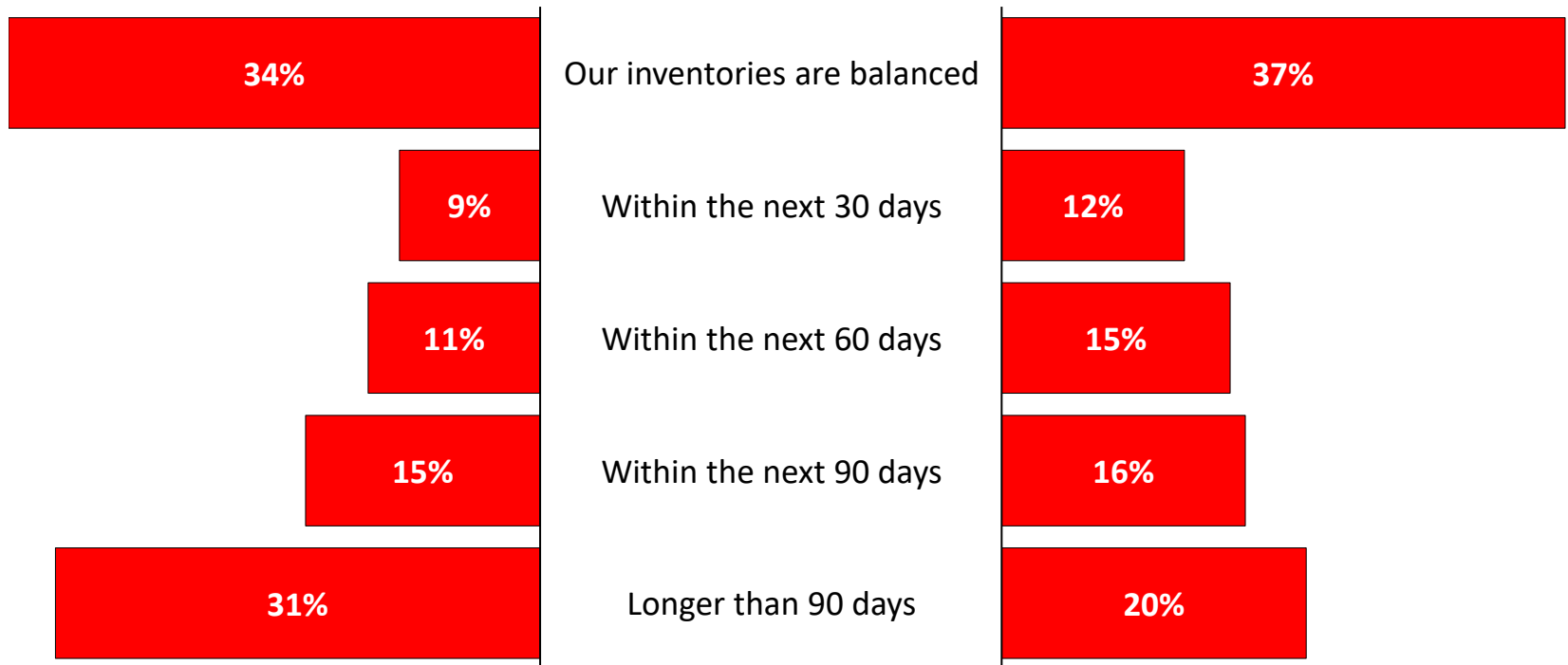


# Inventory Levels

When will your inventories become balanced or at a comfortable level given current market conditions?

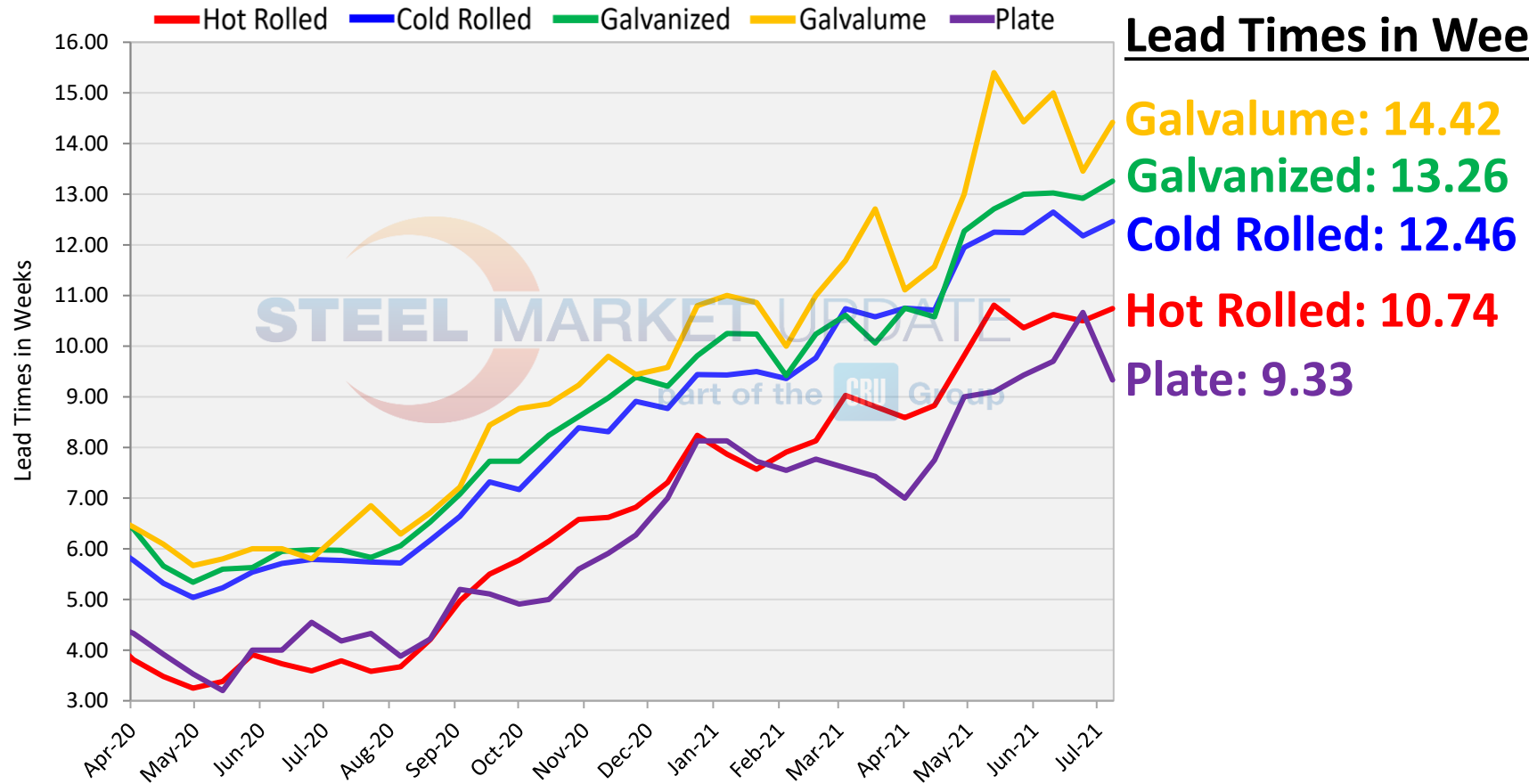
June 24, 2021

July 8, 2021





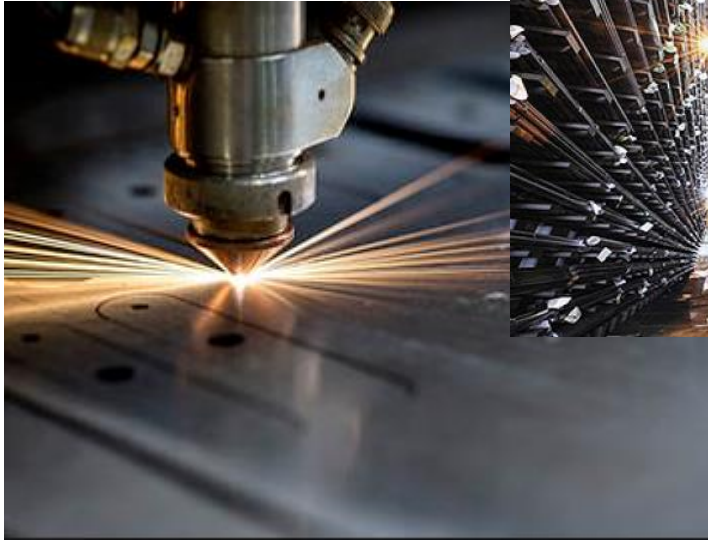
# Mill Lead Times





Dan Sullivan is the founder of Montrose Advisors, an independent M&A and strategic advisory firm that specializes in structuring, negotiating, and executing transactions for middle-market clients in the manufacturing, metals, and industrial services sectors. Prior to founding Montrose Advisors in 2013, he was a senior member of the Industrials Group at Houlihan Lokey Capital for 12 years, and has advised on well over 100 transactions in his career. Earlier in his career, Dan served as a senior aide to Mark R. Warner, the former Governor and current U.S. Senator from Virginia, and helped build his political organization in the 1990s. He holds an undergraduate degree from Georgetown University and an MBA from the Darden Graduate School of Business at the University of Virginia. Dan lives in Chicago with his wife and three children. He serves on the Local School Council at Walter Payton College Prep High School and is a former member of the Board of Directors of Lurie Children's Hospital Foundation, as well as a youth soccer and baseball coach.

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# M&A in the Downstream Steel Markets

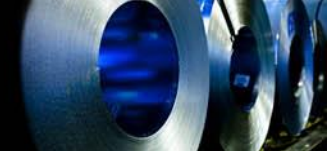
July 2021



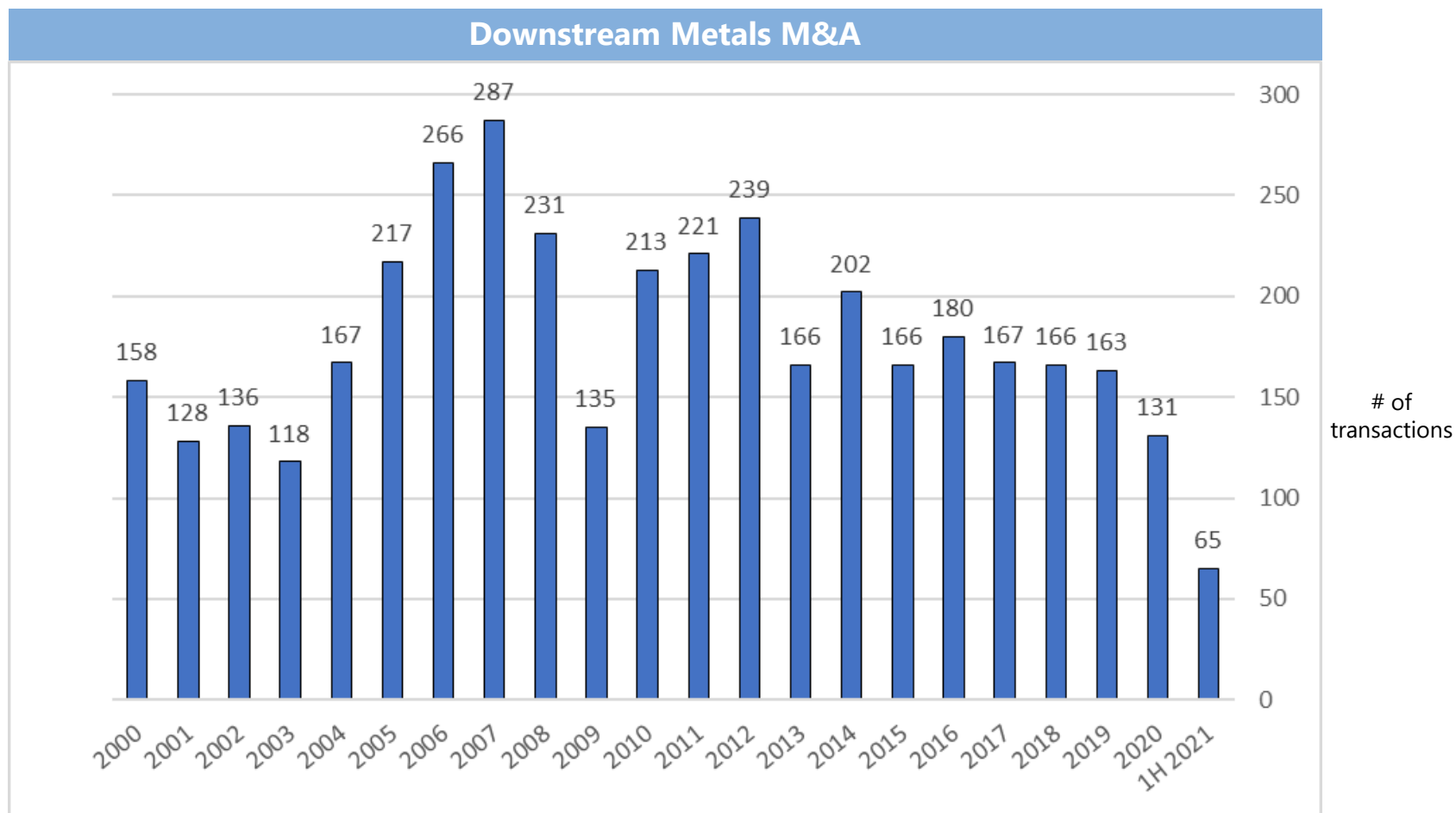
# Agenda

- 1 Overview of Current M&A Environment
- 2 Key Drivers of M&A Activity
- 3 Buyer Types & What They Value
- 4 Valuation Factors
- 5 Post-COVID Wildcards
- 6 What Makes an Attractive Buyer
- 7 Key Factors for a Successful Transaction

# Overall M&A Activity – Downstream Metals



M&A activity in downstream metals sectors peaked in 2007 and has steadily declined since then, with particular crisis-era troughs in 2003, 2009, and 2020



Source: S&P Capital IQ. Represents transactions with US and Canadian targets in the following industry sectors: Metals Service Centers; Rolling, Drawing and Extruding of Metals; Miscellaneous Primary Metal Products; and Fabricated Metal Products

# Why the downward trend in deal activity?

“Irrational exuberance” ended suddenly in mid-2008 and has not returned



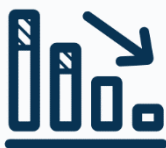
- Long shadow of the Great Recession



- Lack of certainty in the market



- Buyers becoming “choosier”



- Sustained decline in metals shipments

# Activity will recover – but to what level?

## Deal activity is picking up and should increase further



- Vaccines / economy re-opening



- Natural rebound from 2020 market crash; pent-up demand



- Strong economic rebound still has legs



- Several seller-specific factors



- Eventual deal activity level unknown - signs point in both directions

## Chicago Tribune

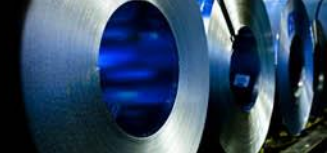
The boss is retiring.




And the kids don't want to take over.

- University of Illinois surveyed 363 family-owned manufacturing companies in the Chicago area in 2019
- 75% had owners over 55 years old
  - 50% of these had no plans for succession
  - 62% had not designated a successor (was 38% in 1989)
- Half of the 600,000 manufacturing workers in Illinois will retire in the next 10-15 years
- Planning is extremely important to realizing full value: “Sell when you don't need to”

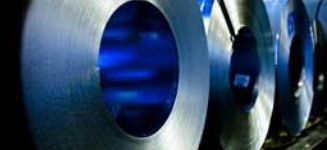






# What is driving owners to consider selling?



| Key Trends                            | Commentary   |
|---------------------------------------|--|
| <b>Robust Manufacturing Recovery</b>  |  <ul style="list-style-type: none"><li>■ Demand returning</li><li>■ Expectation of strong pricing for deals</li></ul>   |
| <b>Management Challenges</b>          |  <ul style="list-style-type: none"><li>■ Aging workforce with significant skill</li><li>■ High competition for labor / difficulty in filling positions</li><li>■ Increasing HR &amp; other non-operational requirements as business grows</li></ul>                         |
| <b>Expense of Staying Competitive</b> |  <ul style="list-style-type: none"><li>■ Service center business have traditionally been a low capex environment</li><li>■ Labor shortage, value-add requirements make expensive equipment critical to ongoing success</li><li>■ Systems requirements increasing</li></ul> |



# What is driving owners to consider selling? (con't)



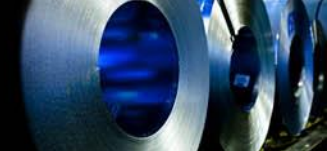
| Key Trends                             | Commentary  |
|--|---|
| <b>Ownership Fatigue</b>               |  <ul style="list-style-type: none"><li>■ Seemingly unending challenges in recent years:<ul style="list-style-type: none"><li>• Great Recession followed by slow recovery</li><li>• Commodity bust followed by tariff-stoked price boom</li><li>• COVID collapse followed by sharp demand recovery and pricing explosion, but severe material shortages</li></ul></li></ul> |
| <b>Taxes</b>                           |  <ul style="list-style-type: none"><li>■ Expectation of higher rates by end of 2021</li><li>■ Long-held businesses will have significant capital gains, making increased taxes more meaningful</li></ul>   |
| <b>Limited Other Liquidity Options</b> |  <ul style="list-style-type: none"><li>■ Service center / fabricator IPOs are rare</li><li>■ General aversion to leveraged recapitalizations</li></ul>  |
| <b>Lack of Strategic Fit</b>           |  <ul style="list-style-type: none"><li>■ Orphaned divisions with no corporate support</li><li>■ Business units that don't match owner's strategic direction</li></ul>  |

# Overview of buyer types

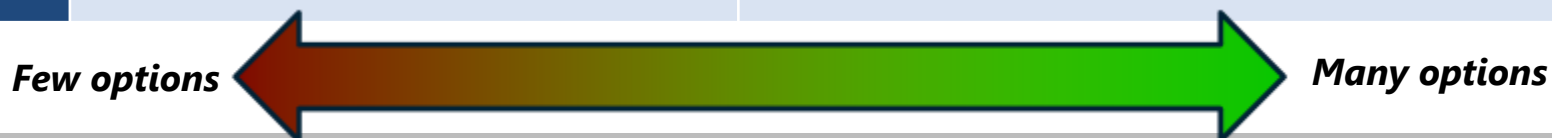
Understanding the goals and tactics of a potential buyer is key to a successful transaction

|                                       | <b>Strategic Buyers</b>   | <b>Financial Buyers</b>    |
|---------------------------------------|---|---|
| <b>Examples</b>                       | <ul style="list-style-type: none"> <li>• <b>Manufacturers</b></li> <li>• <b>Mills</b></li> <li>• <b>Service Centers</b></li> </ul>                        | <ul style="list-style-type: none"> <li>• <b>Private Equity firms</b></li> <li>• <b>Family Offices</b></li> <li>• <b>Hedge Funds</b></li> <li>• <b>Independent Investors / Sponsors</b></li> </ul> |
| <b>Primary Considerations</b>         | <ul style="list-style-type: none"> <li>• <b>Organizational fit / “Industrial logic”</b></li> <li>• <b>Cost and/or growth synergies (1+1=3)</b></li> </ul> | <ul style="list-style-type: none"> <li>• <b>Management / ownership continuity</b></li> <li>• <b>Cash flow generation</b></li> <li>• <b>Definable exit strategy</b></li> </ul>                     |
| <b>Reliance on Financial Leverage</b> | <ul style="list-style-type: none"> <li>• <b>Generally low</b></li> </ul>  | <ul style="list-style-type: none"> <li>• <b>Generally high</b></li> </ul>   |
| <b>Target Hold Period</b>             | <ul style="list-style-type: none"> <li>• <b>Long / Forever</b></li> </ul>   | <ul style="list-style-type: none"> <li>• <b>3-5 years (sometimes longer)</b></li> </ul>   |
| <b>Big Question</b>                   | <ul style="list-style-type: none"> <li>• <b>“How does this acquisition strengthen our existing company?”</b></li> </ul>                                   | <ul style="list-style-type: none"> <li>• <b>“How can we improve this business to generate a return?”</b></li> </ul>   |

# Continuum of value drives multiples



| Key Attributes           | Company A  | Company B  |
|--------------------------|--|--|
| Business overview        | <ul style="list-style-type: none"> <li>Simple distribution / low level processing (e.g. slitting, sawing)</li> </ul> | <ul style="list-style-type: none"> <li>Parts making</li> <li>Several processes in multiple stages (cutting, bending, welding)</li> </ul> |
| Equipment age            | Old  | New  |
| Automation               | None   | Systemwide   |
| Commodity exposure       | Extremely high   | Moderated  |
| Growth prospects         | Low  | High – outsourcing opportunities / business wins from competitors  |
| Customer switching costs | Low  | High   |
| # of competitors         | 8-10   | 1-3  |
| Buyer universe           | Other service centers, liquidators   | Wide variety of strategic and financial  |
| EBITDA multiple in sale  | 4x-5x; often book value or lower   | 7x-8x  |



# Additional factors that enhance value



Strong position in favored end market



High level of strategic fit & synergies



Market consolidation opportunity

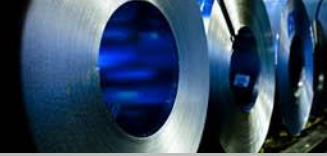


New capabilities / supply chain adjacency



Niche player / limited competition

# Recent acquisition statistics



## Service centers lately have been bought overwhelmingly by other service centers, but the tide could turn

- Over the past 3 years, 85% of service center acquisitions have been consummated by strategic buyers
  - Of those strategic buyers, nearly 90% were other service centers
- Conversely, the buyer universe is much more diverse for high value-added processors and fabricators
  - 50% of fabricator acquisitions have been consummated by financial buyers
  - Service centers and larger manufacturers are also meaningful acquirers in this space
- Financial buyer interest in the service sector was strong during the last metals supercycle; it may re-emerge during a new period of sustained market strength
  - \$1+ trillion in “dry powder”

Sources: Capital IQ, Pitchbook, proprietary information

# Post-COVID wildcards

The world has changed. Uncertainties emerge as the economy reopens.



Valuation



View of inventory risk



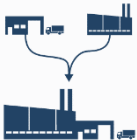
Risk of relapse / variants



Duration of supply shortages



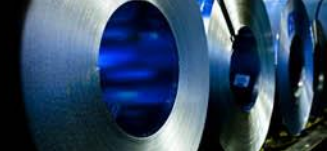
Re-shoring / potential increased shipments






Major deals / Financial buyer re-emergence?



# What makes a buyer attractive to a seller?

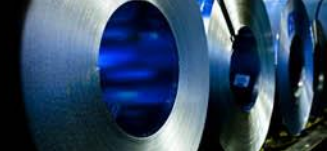






Remember: a good company doesn't need to sell

| Key Elements              | Commentary  |
|---------------------------|---|
| <b>Valuation</b>          |  <ul style="list-style-type: none"><li>■ Always the #1 factor, but never the only factor</li><li>■ At a certain point, money is no longer the deciding factor</li></ul>  |
| <b>Financial strength</b> |  <ul style="list-style-type: none"><li>■ Unquestioned ability to close a deal</li><li>■ Ability to invest to grow the business</li></ul>   |
| <b>Cultural fit</b>       |  <ul style="list-style-type: none"><li>■ Highly important, especially with family-owned businesses</li><li>■ Invest the time to know the people and what makes them tick; rely on their knowledge &amp; expertise</li><li>■ Buyer respects the tradition and legacy of the business</li><li>■ Demonstrated commitment to fair dealing and treatment of employees</li></ul> |

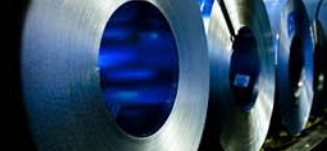


# What makes a buyer attractive to a seller? (con't)






| Key Elements             | Commentary   |
|--------------------------|--|
| <b>Scale</b>             |  <ul style="list-style-type: none"><li>■ Provides purchasing power (for material, benefits, insurance, etc.)</li><li>■ Sophisticated systems to manage increasing reporting &amp; personnel requirements</li><li>■ Increased career opportunities for valued employees / family members</li></ul> |
| <b>Efficient process</b> |  <ul style="list-style-type: none"><li>■ Diligence is organized and timely</li><li>■ Reasonable purchase agreement terms</li><li>■ Productive, solutions-oriented negotiation</li></ul>   |
| <b>Reliability</b>       |  <ul style="list-style-type: none"><li>■ Do what you say you will do when you say you'll do it</li><li>■ Trust is thicker than steel</li></ul>   |
| <b>Patience</b>          |  <ul style="list-style-type: none"><li>■ Selling a company is not the Seller's core business; they likely haven't done it before</li></ul>  |

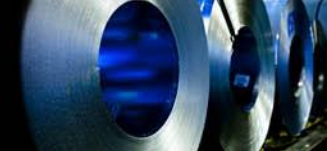
# Key factors that determine a deal's success






## “Soft skills” are of primary importance in a successful closing

| Key Trends                            | Commentary   |
|---------------------------------------|--|
| <b>Communication</b>                  |  <ul style="list-style-type: none"><li>■ <u>The key element in a deal</u>; buyer &amp; seller need to be working together toward a common goal</li><li>■ Frequent, open communication builds relationships and trust, and makes problem-solving a collaborative effort</li><li>■ Establish lines of communication at multiple levels</li></ul>  |
| <b>Cultural &amp; operational fit</b> |  <ul style="list-style-type: none"><li>■ Understand why buyer &amp; seller belong together</li></ul>  |
| <b>Preparation</b>                    |  <ul style="list-style-type: none"><li>■ Management transition identified</li><li>■ Books &amp; records are clean and preferably audited</li><li>■ Working capital issues addressed (long receivables, old inventory)</li><li>■ Legal documentation organized</li><li>■ Data security process in place</li><li>■ Understand tax consequences of different deal structures</li><li>■ Understand post-closing obligations</li></ul> |

# Key factors that determine a deal's success (con't)



| Key Trends                      | Commentary   |
|---------------------------------|--|
| <b>Performance issues</b>       |  <ul style="list-style-type: none"><li>■ Management attention needs to stay focused on the business</li><li>■ Losing key customers, missed projections, quality declines are red flags</li></ul>  |
| <b>Disclosure</b>               |  <ul style="list-style-type: none"><li>■ No negative surprises - identify issues &amp; potential solutions upfront</li><li>■ Good buyers will find out all issues eventually</li><li>■ Even minor lapses in transparency can unravel months of goodwill</li></ul> |
| <b>Other potential pitfalls</b> |  <ul style="list-style-type: none"><li>■ Environmental concerns have killed many deals</li><li>■ Safety issues are a non-starter for many acquirers</li><li>■ High employee turnover</li></ul>   |

# Key Takeaways



Downstream metals M&A activity has been muted in recent years but has the potential to increase sharply



Several converging factors are driving business owners to consider selling currently



Buyer interest - and thus valuation - can vary widely depending on a seller's market position and the strength of its value-add

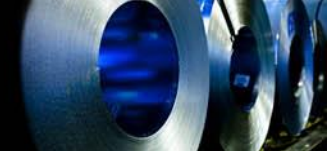


Successful deals are dependent on a host of non-economic factors



Many uncertainties remain for this market as we emerge from the pandemic

**Thank you!**



Daniel P. Sullivan

Founder & Managing Director

Montrose Advisors, LLC

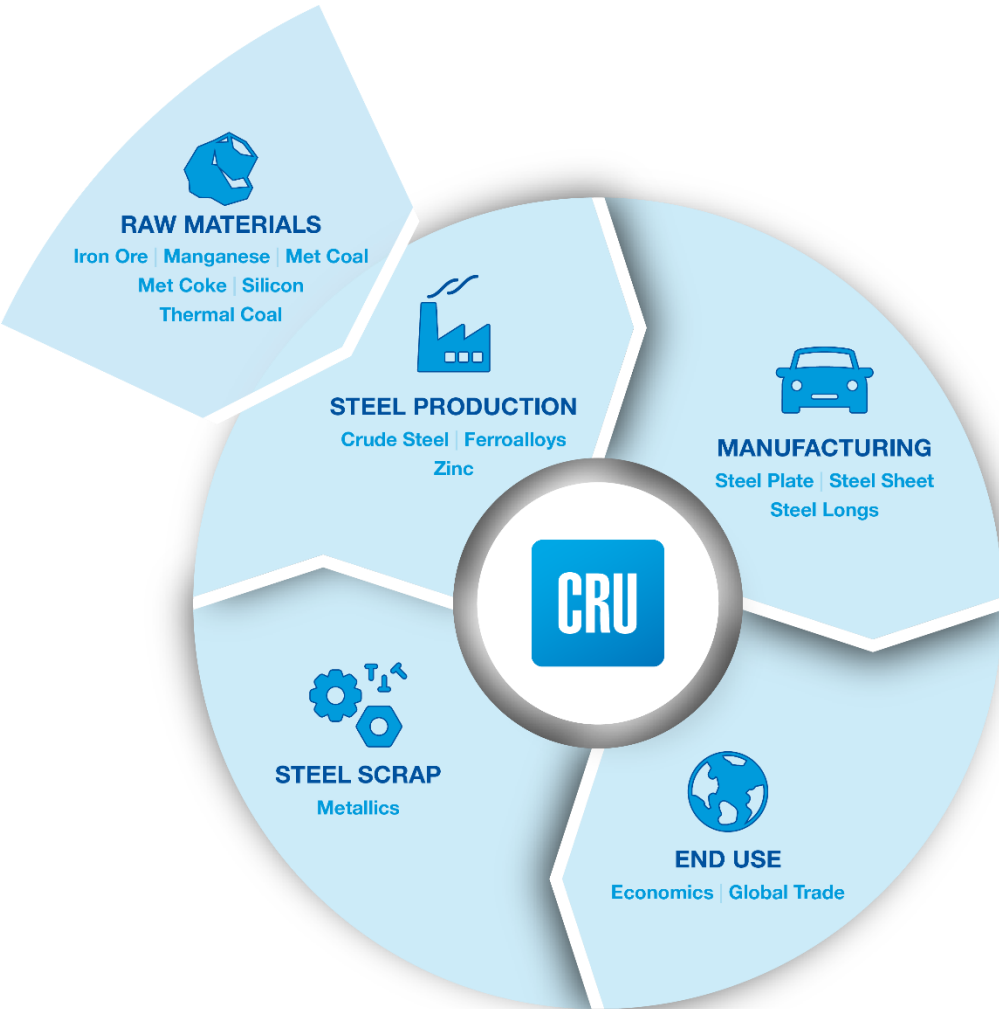
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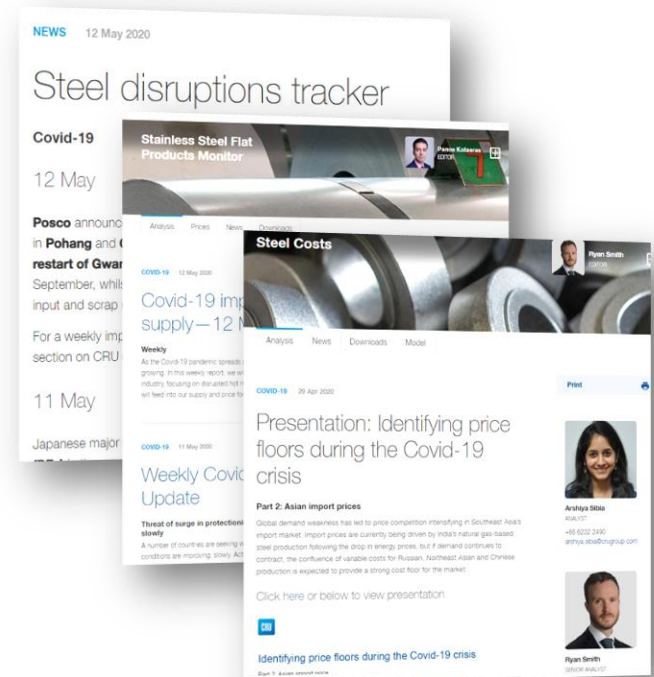
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Bernard Swiecki is Director, Automotive Communities Partnership and Assistant Director-Research Center for Automotive Research

Mr. Swiecki serves as Director of the Automotive Communities Partnership (ACP) at the Center for Automotive Research (CAR), as well as a Senior Automotive Analyst in CAR's Industry, Labor, and Economics (ILE) group. He joined CAR in 1994.

Bernard has written and managed research in a diverse array of automotive fields pertaining to automaker/supplier relationships, electric and alternative powertrain vehicles. He manages CAR's analysis of vehicle sales, production, and segmentation data. He has also led trade missions to China, Italy, India, and Russia



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# Thank You

Thank you for attending our SMU Community Chat. And a special thank you to Mr. Sullivan for his participation today.

Our next webinar is **Wednesday, July 28 at 11 AM ET** with **Bernard Swiecki** of Center for Automotive Research (CAR)

To contact Michael Cowden: [Michael@SteelMarketUpdate.com](mailto:Michael@SteelMarketUpdate.com)

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For information about subscribing to SMU, contact Paige Mayhair: [Paige@SteelMarketUpdate.com](mailto:Paige@SteelMarketUpdate.com)

To participate in our survey: [Info@SteelMarketUpdate.com](mailto:Info@SteelMarketUpdate.com)

Stay safe and stay tuned to Steel Market Update.



The logo features a stylized circular element on the left, composed of two curved segments. The top segment is orange and the bottom segment is red, meeting at a point on the right side. The text 'STEEL MARKET UPDATE' is written in a bold, white, sans-serif font across the middle of the image, with the circular logo partially overlapping the word 'STEEL'.

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part of the  Group

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