American Metal Market

Steel strength to drive service center M&As

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NEW YORK — The service center industry is expected to enter a period of consolidation, largely driven by fragmentation within the sector and by the current strength of the steel industry, according to industry sources.

Following 10 years of "little growth" in the steel industry, companies are finally able to pursue growth opportunities due to the recent improvement in the industry, Peter J. Scott, founder and managing partner of corporate finance and advisory firm Headwall Partners, told American Metal Market.

"There's a fundamental need for companies that need to grow to pursue growth avenues," Scott said, citing capital investments, new facilities, mergers and acquisitions (M&A), among other strategies. "What drives the timing of that growth is typically correlated with cyclicality in the industry."

Service centers in particular are likely to turn to mergers and acquisitions as growth mechanisms since the sector is "highly fragmented," he said. There are many more opportunities for acquisitions in this sector compared with the mini-mill and integrated mill sectors, both of which are already "significantly consolidated."

Consolidation in the mill sector occurred in the early 2000s when many mills went bankrupt, according to Vince Pappalardo, managing director of investment bank Brown Gibbons Lang & Co's metals and metals processing practice. "It made bigger players in the business. Mills became quite a bit stronger."

At the same time, service centers lost their leverage in price negotiations with the mills, Pappalardo noted. Now that the steel industry is regaining its strength, service centers have the incentive to consolidate, to regain their lost clout with mills.

"For a buyer, it's a good time to pursue deals because the financial performance of service centers has been improving," Scott said. "Sellers prefer to sell their companies when the values are higher. There's been a pretty significant increase in the value of service center businesses in the recent past."

Indeed, many service center companies – including Reliance Steel & Aluminum Co, Ryerson Holding and Olympic Steel – are optimistic about 2018 due to strong demand and elevated metals prices.

"When steel prices are higher, there tends to be more M&A activity," Scott noted. "I attribute that more to profitability than direct correlation with steel pricing."

American Metal Market’s hot-rolled coil index stands at $43.04 per hundredweight, up 31.9% from $32.63 per cwt at the start of the year.

But further price volatility could act as a deterrent toward M&A, Scott said, if uncertainty reduced businesses' confidence in pursuing growth opportunities.

The tax reform enacted late last year also has given companies the ability to invest more in their businesses, Pappalardo said. And since there’s always the potential of a future change in the tax law, “it spurs the desire to take advantage sooner rather than later.”

Scott predicted that the consolidation trend is likely to continue as long as the industry is profitable. “The M&A tends to be correlated with profitability.”

A number of service center acquisitions have been announced this month, including Russel Metals’ purchase of Dubose Steel, Ryerson Holding’s buy of Fannello Industries and Union Partners’ acquisition of Maksteel.