RCW MIRUS INDUSTRY
spotlight

# Steel Fabrication & Steel Services

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RCW Mirus Inc. ▲ Investment Banking Services

## Growth and Consolidation

Small steel service companies and metal fabricators have fallen on tough times in 2001 following several years of strong demand and growth opportunities. Industry consolidators, which were once fueled by strong economic conditions, have slowed their "growth through acquisition" strategy. However, many specialty fabricators and steel service companies are still actively seeking and completing strategic transactions to strengthen their market position.

Steel service companies and steel fabricators seeking growth opportunities through acquisition need to realize more synergies than just combining a sales force or administrative functions. Acquisition targets need to meet strategic goals for operational expansion, geographic reach, or diversification of product lines. For example, Viking Industries, a manufacturer of thermoformed industrial parts and custom injection-molded components, acquired Valley City Steel, a steel processor. The operations are complimentary, allowing Viking Industries to expand its product offering and integrate a portion of their value chain, as well as explore new markets.

Financial buyers are active as well. In April 2001, Alenco Holding Company completed the purchase of Reliant Building Products, and Wellspring Capital Partners II announced the purchase of VP Buildings Inc. (LTV Corp.). These financial buyers are betting that they can increase sales and cash flow by providing a combination of capital and management experience.

## Value Drivers

RCW Mirus believes the following points are critical in driving premium pricing for middle market steel services and steel fabrication companies.

- *Processing Capability* – Players that have the expertise to manufacture a number of different products can meet a wide range of customer needs. These capabilities attract multiple buyers and drive higher valuations.
- *Solid Earnings* – Acquisition targets with solid earnings can be immediately accretive to the buyer's bottom line. During times of economic difficulty, this can be a strong motivator to seek and complete transactions.
- *Strategic Fit* – Companies that can fill a void are particularly attractive because they can provide access to new customers through cross-selling opportunities.
- *Realistic Expectations* – A typical acquisition takes approximately 6 to 9 months from initial contact with an investment banker. Companies that begin the process before they are in financial trouble retain more bargaining power, and can often entertain multiple offers.

## Recent Transactions

The industry consolidation is occurring at lower valuations than just one year ago. However, many middle market companies are still experiencing acquisitions at favorable valuations. The following is a list of selected recent transactions:

- Reliance Steel and Aluminum Co. acquired Pitt-Des Moines, Inc., May 2001, $97.5 million
- AK Steel Holding Corp. acquired Alpha Tube Corp., June 2001, $30.0 million plus assumption of operating leases
- Illinois Tools Works, Inc. acquired Foilmark, Inc., April 2001, $54.6 million
- Pinkert Industrial Group acquired Leavitt Tube Co., March 2001, $32.0 million

## Industry Trends

Steel service and steel fabricators are experiencing the classic symptoms of an economic downturn. Reduced demand has forced them to reduce their workforce and drop their prices to move their inventory. This strategy has worked in the past, but it may not be enough this time.

Within the last six months, steel producers Republic Technologies, Trico, GS Industries, and CSC Ltd. have filed for bankruptcy protection, contributing to the estimated 25% of the total U.S. steel production capacity that is protected by Chapter 11 (*ENR*; New York; June 25, 2001).

In addition, merger and acquisition activity in the steel production sector has been accelerating. For instance, Usinor is in talks to merge with Arbed of Luxembourg and Aceralia Corporacion Siderurgica of Spain, which would create the world's largest steel producer. NKK and Kawasaki, Japan's No. 2 and 3 steel makers, have also announced plans to merge operations.

In 1996 and again in the spring of 2000, demand for steel products outstripped supply resulting in the institution of allotments and wait lists. Small metal fabricators and steel services companies were hit especially hard because of the subsequent loss of market share to larger companies. With the current consolidations and bankruptcies of steel producers, a turnaround in the economy may lead to the same supply and demand dynamics.

In light of these trends, it appears that the small steel service companies and metal fabricators will still face tough times when the economy does recover. Industry consolidators, such as Reliance and USA Metals, will maintain purchasing power in the face of large steel producers while smaller companies have fewer options for procuring steel stock.

**If you would like to discuss consolidation and mergers and acquisitions in the steel fabrication industry, please contact Jamie Grant at 617-338-1333.**

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