American Metal Market

Metals execs' optimism to drive M&As: survey

Apr 14, 2017 | *08:11 AM* | *Grace Lavigne*

NEW YORK — The vast majority of North American metals industry executives are brimming with optimism and have widespread plans for deal-making in the coming years, according to a recent survey by Headwall Partners LLC.

Although the overall conclusions of the survey were not unexpected, the degree of unanimity among the responses was surprising, Headwall Partners managing partner Peter J. Scott told AMM.

None of the roughly 25 C-level executives—those with titles typically beginning with "chief"—surveyed in March were pessimistic about their companies' financial performance over the next three years vs. the preceding three years, and there were no negative expectations whatsoever about the impact of President Donald Trump's administration on the economy of the United States. The survey included responses from high-level executives in North America representing steel mills, scrap processors, metals service centers, metal processors, nonferrous metals companies and more, according to the Greenwich, Conn.-based advisory firm.

More specifically, 96 percent of survey participants said they were optimistic or strongly optimistic about their financial growth for the coming three years, with only 4 percent saying they expected growth to be about the same. None of the respondents indicated the "pessimistic" or "strongly pessimistic" options.

Additionally, 92 percent agreed that the Trump administration would have a positive or strongly positive impact on U.S. gross domestic product (GDP) growth in 2017 and 2018, with 9 percent predicting little or no impact and none selecting "negative" or "strongly negative."

Much of the metals industry's optimism is tied to the Trump administration's policy initiatives, particularly considering the Republican Party's control of both chambers in Congress, according to Scott. However, "it's clear that announcing public initiatives is easier than finding compromise between the two parties in Washington and executing those policy changes. We'll see how successful the administration is at passing and implementing the policy changes that they've announced."

Regardless, the pervasive optimism is expected to drive more merger and acquisition (M&A) activity, according to Scott. The survey showed that the executives have extensive plans to use such activity to further their growth strategies, with 96 percent of respondents expecting their companies' mergers and acquisitions to be about the same, more active or significantly more active over the next three years vs. the past three years.

"Management teams don't want to take on the risks of an acquisition if they don't have optimism about their own financial performance and the overall economy," he said. "The optimism in the sector that's reflected in the survey is an indication of confidence and the willingness to pursue transactions that one or two years ago might have been viewed as too risky to pursue."

Over the past decade, the metals industry has experienced "very little organic growth" amid declining volumes and relatively flat pricing, according to Scott.

In a minimal-growth market, the best way to capture market share is with a "consistent, systematic approach to M&A," he said.

"The companies that are consistently in the market buying smaller and larger companies in their core area of expertise are the ones that have dramatically outperformed on a shareholder return basis over the long term," Scott said. "In order to outperform peer competitors, M&A is the key differentiator."

Service centers focused on value-add opportunities vs. simple stock keeping, and mills focused on investments in downstream products rather than commodity products, for example, are strategies that make sense, he said.

"None of these companies are investing in a whole new area; they're focused on businesses that are core to what they're already doing, or allow them to add incremental value to products that they're already focused on," Scott added.

In terms of debt, "many of the companies that needed to refinance their balance sheets were able to do so in 2016 and early 2017, and are now positioned to be able to pursue M&A opportunities," he said.

Because a new cycle of M&A activity is now beginning, the majority of that activity will likely involve more middle-market companies over the next several years, according to Scott.

"There may be blockbuster mergers that occur, but the first stage of the M&A wave that we're entering into is going to be dominated by midsized companies" with revenue ranging from about $50 million to $1 billion, he said. "In other words, larger companies acquiring midsized companies, as opposed to the largest companies (in the industry) coming together."

Scott noted three key elements necessary for companies to successfully implement a systematic approach to M&A activity: A balance sheet with the capacity to make acquisitions, viable acquisition targets within a relevant realm of expertise, and enough manpower to integrate the two companies post-acquisition.

Scott, a former investment banker at Jefferies LLC, founded Headwall Partners last year and predicted at the time that deal-making in the steel sector would increase in the coming years.