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Assessing Mergers and Acquisitions in the Metals Industry

September 26, 2017

Presented By
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About Today's Speakers

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Agenda

- Describe the current state of the metals industry and how the landscape for mergers and acquisitions is changing
- Discuss due diligence considerations specific to the metals industry and how they impact evaluation of a potential target in an M&A setting
- Recognize how advances in technology and business process automation have affected the industry
- Outline key considerations impacting whether an M&A transaction makes sense for your business

Current State of the Metals Industry

- Global Overcapacity
  - Negatively impacting primary metal pricing on a global basis
  - Perceived unfairness in the global production market drives concern about subsidized pricing in certain geographies
  - Domestic US demand over prior three years has remained steady –recent uptick in demand in the US auto market offset by lower OCTG demand related to energy production
  - Record supply from China set against slowing overall global demand continues to put downward pressure on prices

Current State of the Metals Industry

- Downstream Expansion
  - Focus on more value-added services for the end customer
  - Higher margin services make profitability less dependent on the fluctuating cost of the metal
  - Expanded customer service “one-stop-shop” provides for ability to compete on the basis of convenience vs. pure price

Current State of the Metals Industry

- Consolidation
  - Historical tendency toward regional players in the US metals industry
  - Competitive landscape has dictated consolidation to take advantage of buying power, economies of scale and improved servicing for large customers
  - Increasing sophistication of customers requires infrastructure to support more demanding delivery and production schedules

Current State of the Metals Industry

- Bright spots in US
  - Residential construction
  - Commercial construction
  - Military and aerospace
  - Infrastructure
  - Clean energy
- More challenged channels
  - Traditional energy/fossil fuels
  - Automotive

Polling Question One

In your opinion, during FY18 what will be the biggest driver of domestic metals prices.

a. Foreign demand
b. Governmental regulation
c. Raw materials prices
d. Domestic demand
e. Foreign supply

Landscape for Mergers and Acquisitions

- ## Deal Environment
  - After consecutive years of decreases, deal volume FY16 and FY17 continues the negative trend
  - Uncertainty surrounding the trajectory in base metals prices, combined with weakening demand in China, provides a headwind in FY17
  - Stronger players are driving transaction volume, centered around vertical integration and consolidation strategies
  - Consolidation is not expected to be as much of a driving force for M&A activity in certain areas of the metals subsector – specifically areas such as ferrous scrap, where there is a low value to weight ratio
  - Select transactions are benefitting from foreign investors paying a premium for US “beachhead” acquisitions

Landscape for Mergers and Acquisitions

- In addition to defensive M&A activity, there remain certain areas of growth in metals transactions
  - Transactions driven by innovative technology
  - Growth related to newly relevant geographies

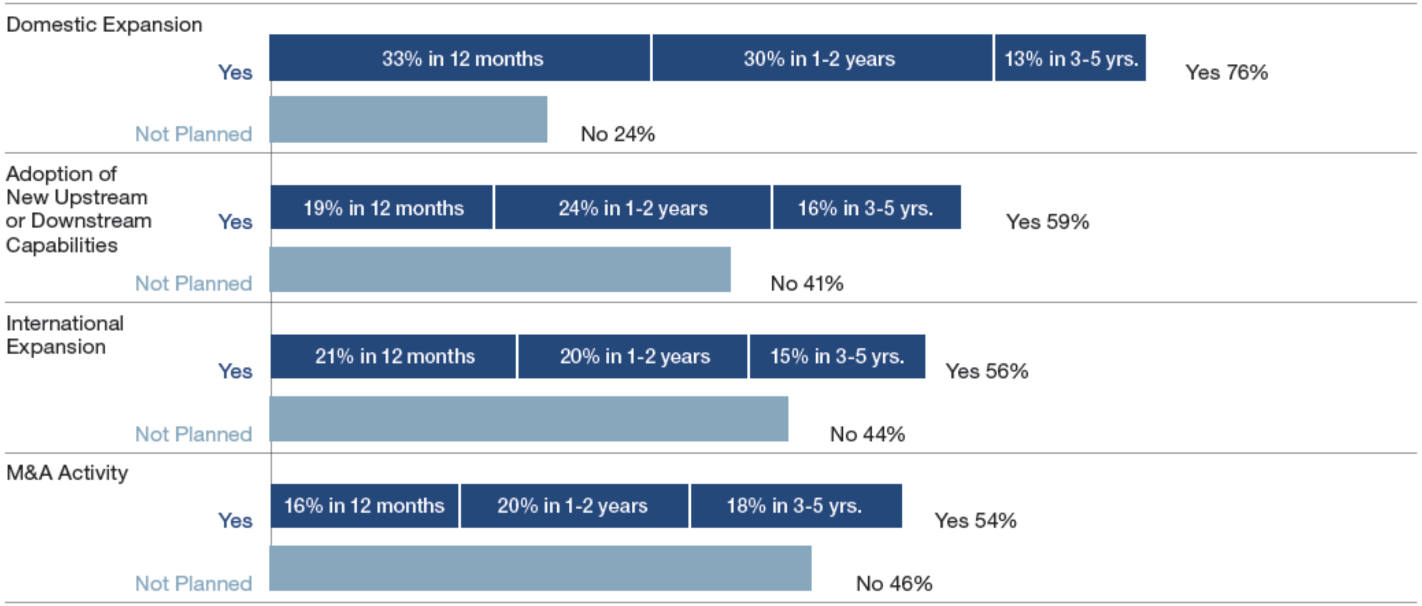
Deal Environment - 2015 and 2016 Deal Survey Results

1. Which best describes your company situation related to 3-5 year plans for growth and expansion?

   a. M&A activity (within 12 months, 1-2 years, 3-5 years)
   b. Domestic expansion (within 12 months, 1-2 years, 3-5 years)
   c. International expansion (within 12 months, 1-2 years, 3-5 years)
   d. Adoption of new upstream or downstream capabilities (within 12 months, 1-2 years, 3-5 years)

Key Finding: 76% of respondents are planning domestic expansion, 59% are planning adoption of new upstream or downstream capabilities, while 56% are planning international expansion and 54% are planning M&A.

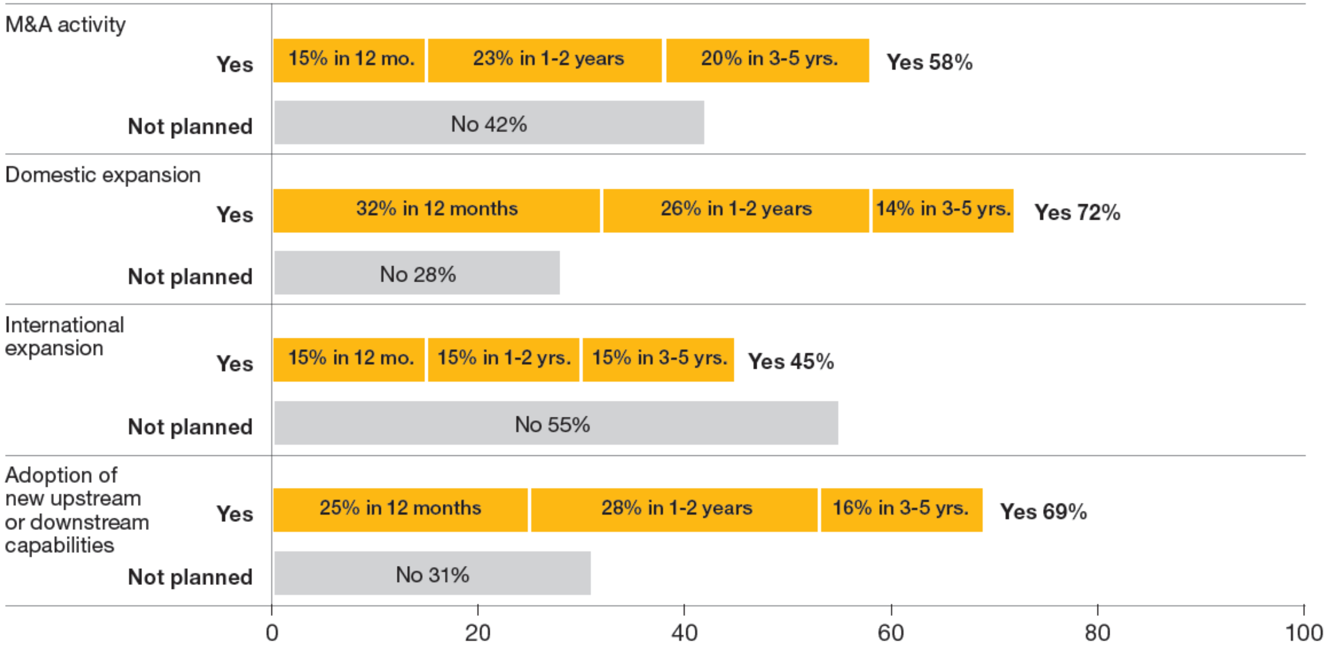
- Mainly in the short term (in the next two years)



Deal Environment - 2015 and 2016 Deal Survey Results

1. Which best describes your company situation related to three- to five-year plans for growth and expansion?

Key findings: Plans for international expansion sometime in the next five years are down 10 percent from the previous year's survey responses and plans for the adoption of new downstream capabilities in the next five years are up 10 percent.



Polling Question Two

In your opinion, during FY18 what will be the biggest driver of M&A activity.

a. Downstream expansion
b. Scale/price leverage
c. Geographical expansion
d. Other

Deal Evaluation

- Financial Due Diligence - Key Topic Overview
  - Overall evaluation of the Target
  - Quality of earnings
  - Evaluation of working capital
  - Historical and prospective CAPEX

Deal Evaluation

- Overall Evaluation
  - Understand the target’s susceptibility to external market fluctuations
    - Metals prices
    - Foreign currencies
  - Determine how much risk has been assumed and how it is managed
  - Evaluate the level to which “value-added” services contribute to earnings

Deal Evaluation

- Quality of Earnings
  - Understand the movements in relevant base metal markets during the evaluation period
  - Outline the details of mechanisms that impact purchase and sales price
    - Timing of metal price indexing for purchases and sales
    - Volume of fixed price delivery agreements
    - Inventory level requirements

Deal Evaluation

- **Working capital**
  - Working capital mechanisms are typically more complicated when commodities impact balance sheet items
  - Market fluctuations in major raw materials during an analysis period can contribute to a meaningful transfer of value that might not be equitable when evaluated over a longer period
  - Relationships between key balance sheet ratios, i.e., inventory days, AR days, and AP days are always important, however changes in these relationships can be magnified when metal price and foreign currency dynamics are factored in
  - Issues related to level consigned inventory

Deal Evaluation

- **Historical and Prospective CAPEX**
  - The trend toward more downstream processing capabilities makes CAPEX increasingly relevant to deal valuations
  - An understanding of historical and projected CAPEX bifurcated between “growth” and “maintenance” is essential
  - CAPEX can results in a complicated discussion when seller has recently upgraded capabilities with a significant investment in CAPEX
  - A mechanism similar to a working capital adjustment might be helpful in finding a middle-ground for CAPEX intensive operations
  - Analysis of historical R&M costs as well as history of upgrades or major overhauls of key equipment can help flag potential requirements for additional future operating or capital expenditures

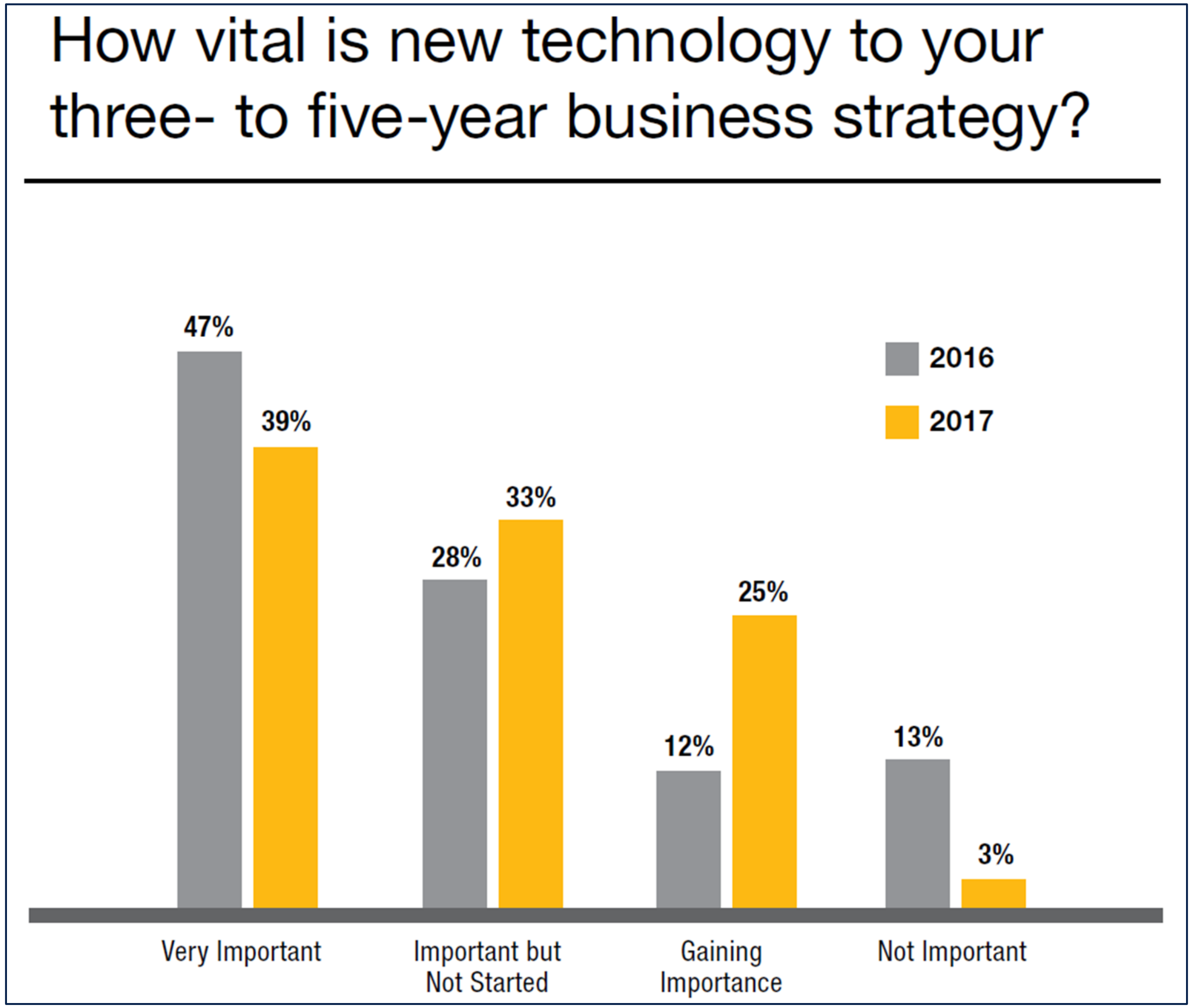
Polling Question Three

In your opinion, what is the most challenging aspect of a metals industry due diligence project.

a. Normalizing earnings for market fluctuations
b. Establishing a working capital target
c. Estimating synergies
d. Other

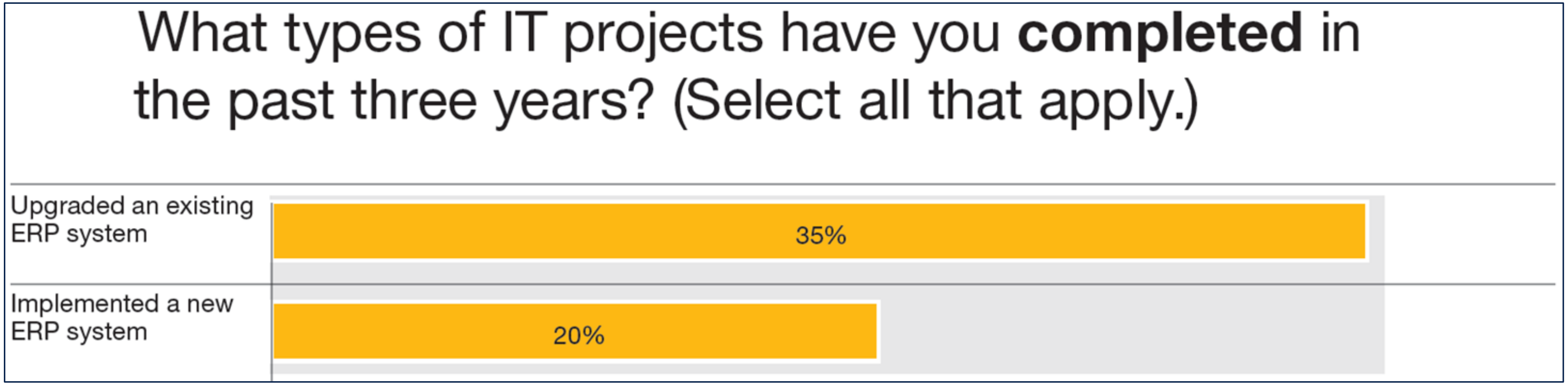
M&A and Technology

- Enterprise technology must be considered for both pre- and post-transaction activity
- Multiple functional areas can be improved with technology investments
- Latest survey results showed >60% of businesses do not tie technology investments to business strategy



M&A and Technology

- Noticeable growth in technology investment in metals in the last three years



Polling Question Four

What is the more important benefit to having state-of-the art technology in the metals industry.

a. Inventory management
b. Accurate cost accounting
c. Customer relationship management
d. Other

M&A and Technology

- New technology solutions are enabling faster, more specific industry solutions for the metals industry
- Important factors to consider when evaluating new enterprise technology
  - Scalability
  - Compatibility with customer or vendor systems
  - Reporting functionality

Key Considerations about Potential M&A Activity

- Some items to consider when determining if a transaction makes sense for your business
  - Diversification - Is there a need to diversify metals market risk through exposure to additional geographies or products
  - Capacity – Do you currently possess excess processing capacity or are you struggling with bottlenecks in certain areas
  - Customer Service – Are you in danger of losing key relationships due to holes in your product offerings, service offerings, or geographical scope

For more information, contact:

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