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## Selling Your Service Center

*Before the Sale*

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*Proper planning one year or more in advance of going to market will give you the best chance of getting the most value in a transaction.*

It's a choice many service center operators will be faced with some day: Is it time to sell the family business?

If that question is one you envision asking yourself in the future, you would be wise to start planning for that long before the time you put the figurative "For Sale" sign outside the door to the company headquarters.

Selling your service center, an act you will likely only experience once in your lifetime, is a lot more complicated than offloading a steel coil or piece of plate. It is a task that takes time, patience and, ideally, the input of outsiders to ensure both a process that goes smoothly and an outcome that is most satisfactory.

Metal Center News spoke to a handful of those advisors, investment banking operators who specialize in the industrial metals space, for some advice on what steps you need to take before you put the business on the market.

One area of agreement – the earlier you start, the better your chances of a successful outcome.

“If you know you are going to sell your business, it is never too soon to start planning. Remember that many of the plans that will increase the value of your business, such as investing in a new facility or equipment, can take a few years to see financial results so that they result in a better purchase price. Similarly, it is not uncommon for tax planning to take multiple years to complete. Even if your timeline is three to five years out, you can start planning now,” says Bill Sales of Heritage Capital Group.

“The sooner the better. You can work with any timeline, but the more prepared somebody is, the smoother things go and the better you present to buyers,” says Dan Sullivan, founder of Montrose Advisors. “And that leads to better outcomes.”

Conversely, “The worst thing that can happen is if you have your hand forced. The patriarch dies, there’s a tax bill to be paid and you don’t have a choice but to go into the market and sell your business at a time that is not of your choosing,” says Peter Scott, managing partner for Headwall Partners.

One way of avoiding poor timing is to be regularly preparing, regardless of your intentions. “There is a whole school of thought you should always be running your business as if it’s for sale,” says Alberto del Pilar, managing director of Butcher Joseph & Co. “It’s an exercise in assessing your company from the perspective of a buyer.”

This kind of planning has two main benefits. It puts you ahead of the game if unforeseen circumstances, such as that sudden death of the operator, force a need to change direction. Additionally, constantly preparing oneself for a sale, and all that entails, often makes the business itself stronger.

“Anything that derisks your number is beneficial if you want to transact, either on a sale or if you want to raise outside capital, which a lot of companies look to do,” says Michael Jenny, managing director in the investment banking group for Stout Capital.

Tragedy, of course, is not the only reason service center operators may be looking for an exit strategy. Occasionally, the primary shareholder is simply ready to move on and there’s no one interested in taking over the family business. And, sometimes, the next generation is willing, but not able. “Not everyone is built to be an entrepreneur or run a business,” says Vince Pappalardo, managing director of Brown, Gibbons, Lang & Company’s Metals and Metals Manufacturing Group.

Pappalardo defines the time to sell as when “the risk tolerance changes between what the company needs and what the shareholder needs.”

He says the company should be looked at as a separate entity, one that needs to grow, expand and create opportunities for its employees. At some point, the shareholders may not want to take the risk that comes with such an approach, such as putting in a new piece of machinery. When that day arrives, it's time to look for an exit.

How does one prepare for that sale one or two or three years down the road?

“What's key is really getting your financial house in order. That will typically mean having, at the very least, reviewed financial statements,” says Michael Mufson, managing director of Mufson Howe Hunter & Company LLC.

Jenny advises businesses to undertake audited financial statements. “We're working with a metals business right now who has an eye toward selling in 2027 so we're helping them shore up their fiscal 2025 audit, which would be qualified because they don't have a prior-year comparison. They could then have an unqualified audit for 2026 and launch a sales process in 2027, if they want to.”

During the diligence process, companies can discover expenses of the existing operations that can be adjusted for, “anything that would be an expense relative to the family ownership group that might not extend to new ownership,” says Jenny.

Scott agrees. “It's perfectly appropriate in a family-owned business for the management team to be taking out compensation that is far greater than an arm's-length, third-party manager might be warranted to take. You can either burden your profitability with that and it will impact valuation, or you can make an adjustment, which we call an add-back.”

Ultimately, sound books that can survive a thorough due diligence process is an essential to move a sale forward.

Beyond the financial side, there are other areas that may need to be addressed. Chief among them is any environmental issues your operation is facing. “Even though you think you run a clean shop, it's a good idea to do a Phase 1 study at your facility to be sure, or to have the opportunity to resolve any issues it identifies before you put your business on the market,” says Heritage's Stan Baucum.

And, Jenny suggests, if your business is one with multiple locations, all of this should be provided on a site-by-site basis.

Sullivan says all of the company's assets need to be well-invested in during the period before a sale. “That is keeping up your equipment, keeping up your safety practices, having good clean inventory.”

One key aspect of the run-up to a sale is making sure all of the shareholders are onboard with the process and largely working in the same direction.

“Are all the shareholders committed to the deal? Does the existing shareholder agreement address how to handle a change in ownership? You must be able to answer ‘yes’ to both of those questions before the sale can move forward,” says Heritage Capital’s Doug Kravet.

That’s not always easy. “In third or fourth-generation companies, there could be a lot of shareholders. They don’t always have the same opinions,” Sullivan notes.

All of this makes communication essential. It must be done early and often during the process. You don’t want a reluctant shareholder standing in the way between you and a sale.

One thing crucial to remember is that while you are expected to perform a complete due diligence on your operations, the buyers will execute a similar strategy. And you don’t want them to find an issue in theirs that should have been addressed, or at least acknowledged, in yours.

“People will come in and see a yellow flag. That can be handled with money. But then they get paranoid there’s a red flag they can’t see,” Pappalardo says.

Sullivan says buyers can quickly sour on a deal if they find an issue that should have been revealed by the seller. “This is still an industry that works on personal trust. It can get you through a lot of issues. But if you break that trust, it can kill deals quickly.”

These men believe a company’s best bet at attracting top dollar, as well as making the process run smoother, is to tap outside talent, themselves included. “We don’t run metals businesses. We sell them all day, every day,” Jenny reasons.

“We recommend using investment banks because there are a lot of obvious benefits. Process is critical,” says Scott. “We put that through in the form of a confidential information presentation, a 40-50 page detailed presentation of the attributes of the company being sold that allows a potential buyer to evaluate it from a strategic perspective. Embedded in that is the financial information and we do a lot of work to make sure it is rock solid.”

Putting together the company’s “story” is inherent to what the bankers do, working from the perspective of what they know buyers are looking for. That includes sales, stable gross profit margins, customer or supplier diversification and other key metrics, del Pilar says.

“Buyers don’t want to do a lot of work to look at potential acquisition candidates. They want someone to present the company, packaged with due diligence done and models tied to books and records, so they can make a quick offer for the company,” says Mufson.

But the role of these outside advisors goes beyond just putting the company’s picture

together. They guide the sellers to address all of the issues that potential buyers will be considering, helping them shore them up before going to market.

Additionally, while long-time service center operators may have a wide network of colleagues in the distributions space, there's little chance they know all of the potential acquirers. The bankers will have access to not just the well-known strategic buyers, such as Reliance or Ryerson, but also the private equity firms and even the occasional international enterprise.

Moreover, one of the key things to remember is that while the process itself is time-consuming, the business of the business must go on. By allowing the bankers to guide the due diligence process, it allows the service center owners to focus on running the company.

"Even if we're running a full process for you, you need to be running your business every day as if it's never going to sell. Don't lose focus on the day to day," says Heritage's Mike Young.

And it isn't just bankers who should be involved. Tax professionals, accountants, lawyers and other professionals can help with many steps along the way. "Externally, people a lot of time fail to bring in attorneys or CPAs, because they don't want to pay them, which is insane," says Tenenbaum. "You don't want to wait until toward the end to get these people involved and find out you're going to have a tax situation you weren't expecting or there's language in one of the agreements that aren't in your favor to the extent you now want to pull out."

What mistakes are made? Perhaps the first is thinking you can walk away on Day 2. That's certainly not true if you're still heading up the company until closing.

"There's a misconception that people can sell their business and leave. Most buyers want current leaders to stay 18 to 26 months post close," Mufson says.

To the extent it was ever possible, it's not that way any longer. "If you're the guy making the day-to-day decisions, you're not walking away," Pappalardo says. "Ten years ago, there was sometimes a depth of management with the buyers where they could parachute somebody in and run the place. People are a lot leaner now and they don't have those mid-level guys you can plug and play."

Even if it existed, most acquirers value that level of familiarity with the customer base and employees that only existing management truly has. They're not just buying your steel and equipment, but the reputation you've built.

“If you’re valuable, you’re doing something someone else isn’t. The buyer is going to want to keep that,” Sullivan says. “You have to prove the business can keep running after the sale, either because the owner is going to stick around or the next generation is ready to go.”

Now, owners who prefer to move away from the business at the time of the sale can do so if they turn over control of the day-to-day decision making to a leadership team that will stay on after the sale is complete. But, for many operators accustomed to heading up businesses, that’s often easier said than done.

Tenenbaum recommends a succession plan for the management of the business. “Buyers want to purchase companies that have effective management teams that will run the business post-transaction.”

While the buyers appreciate your expertise and customer relations, other traits may not be so valued. If the patriarch of is good at timing buys, the seller is going to account for that when it comes to valuation.

“Buyers of businesses will adjust for that and not reward the company for the ability of the CEO to speculate. One, that speculation carries risk. And two, the value of that speculation is not embedded in the assets the acquirer is acquiring,” Scott says.

Once the sale process gets started, the buyers will want to proceed quickly. Many of the strategic buyers will be weighing multiple options, so the ones that are consistently ready to go will get prioritized over others where the exchange of information moves along more slowly.

“There is an old saying ‘Time Kills Deals’. The longer it takes, once we start a process, the more risk there is to the transaction. We help our clients by instilling a sense of urgency to move this along as quickly as possible,”

says Heritage’s Chad Potter. “At the same time, you have to know the market. We tell clients to anticipate a six- to nine-month timeline for their transactions to complete, from the gathering of essential information, the early stages of marketing the business and through the completion of due diligence.

“Time is the enemy of the deal,” Sullivan adds.

So what can you expect in the offer? Sadly, perhaps not as much as you’d like.

“Many owners feel their businesses are worth more than it really is. The process should start with a valuation so you can have a realistic expectation of the value of your business. All valuations begin with complicated financial modeling and follow a standard playbook,” says Heritage Capital’s John Montgomery. “However, in the end, the only way you’ll truly know what your business is worth is by going to market and getting competitive bids.”

Companies may see one sale go through with a multiple of 7x EBITDA and expect to get something similar, but it doesn’t necessarily work that way. Mufson says you can generally expect a 4 to 6x multiple for a commodity-based service center with little processing up to 5 to 7x when there’s more value-added or you have a niche product or particular geography. “Most of the buyers are pretty sophisticated,” he says.

Additionally, “The reality is, multiples adjust over time. What we typically do from a valuation perspective is we look at a cycle average EBITDA, and then a cycle average EBITDA multiple. It’s a lot of math, but it ends up coming to a smoother set of valuations,” Scott says.

Price, of course, isn’t the only consideration for a privately held business. When an operation has been in the family for two or three or four generations, the attachment is strong, one that doesn’t evaporate the moment new owners take over.

Thus, owners may be looking at more than just the dollar amount. They want to make sure the family name stays above the door. Or that the customer base is supported. But most often, what they really want, is to protect the men and women who come to work every day.

“What happens to the jobs is a big concern. And what happens to the jobs directly impacts what happens to their legacy in the community,” del Pilar says.

Similarly, the offers will include variations on what the buyers are looking for.

“When you go through a sales process, you’ll get term sheets from a number of people. You’ll notice they can be very different in what they’re asking for, how they think about realization of projections – who bears that risk and reward,” del Pilar adds.

Ultimately, the sale of smaller service centers to strategic larger players or private equity firms will continue, likely at an accelerated pace. “Steel service centers are like community banks were 30 years ago. They’re just going to get eaten up and people will buy them for market share. The next generation will have fewer of these companies,” Mufson says.