

Customer & Market Due Diligence Of Industrial Wastewater Treatment Service Provider: Establishing Pricing Structure, Margin Risk, And Growth Outlook

The Challenge: One of our PE clients was preparing a check-in bid for an industrial wastewater treatment facility operator handling non-hazardous liquid waste streams such as oily waters, soapy waters, and leachate. The target had made four recent acquisitions and was expecting to continue its growth through further acquisitions. The target also was expecting organic growth due to increased demand for sophisticated wastewater treatment services. While excited by the target's growth potential, our client asked Gotham to conduct a 2-week customer & market due diligence ahead of the check-in bid to: (1) establish margin sensitivity to oil prices; (2) assess recession risk; (3) establish competitive positioning; (4) establish growth outlook of the industrial wastewater treatment services market; and (5) validate the target's growth opportunities.

Rapid Pre-check-in Bid Margin Risk And Growth Assessment: To address our client's due diligence objectives, Gotham undertook a multi-pronged, data-driven effort, that included:

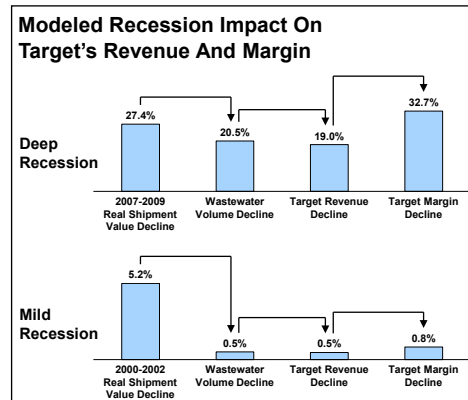
- Conducting 50+ interviews with corporate managers, EHS professionals, facilities managers, engineers, environmental managers, and strategy professionals across various end-markets to gain insights into: wastewater generation and treatment; outlook for production activity and wastewater volumes by end-market; competitive landscape and competitive behavior during recession; pricing structure and historical trends; and purchasing process, vendor selection criteria, and target's reputation/positioning
- Developing an oil price sensitivity model to profile margin impact by analyzing intra-month oil price movements and pricing-related exposure of recovered oil
- Developing a recession model by analyzing the target's invoice data and establishing wastewater collection profiles for target's customers, including frequency of pickups and size of collections, as well as impact of deep and shallow recessions by end-market (e.g., automotive, industrial, automotive repair, consumer goods, landfills)
- Validating growth outlook assessment for key end-markets by leveraging industry data and conducting secondary research.

Limited Oil Price Exposure Due To Target's Price Adjustment Mechanism, A Practice Not Common In The Industry

Gotham's oil price sensitivity model revealed that while the target hedges some of its revenue to limit exposure to oil prices, a significant majority of its revenue was still exposed. However, the target adjusts wastewater treatment prices based on oil prices as its pricing model considers the value of the recoverable oil in the oily wastewater, a differentiator in this industry with its antiquated pricing mechanisms. In examining margin sensitivity to oil price changes over the past 20 years, Gotham's model revealed a theoretical downside risk of ~2% of revenue from the intra-month movement in oil prices associated with a ~30-day lag between purchasing and selling. We also established that customers may be open to accepting 3-5% price increases.

Recession Exposure Dampened Due To Diversified Waste Streams And Volume Under-indexed To Production Activity

While about one-half of the target's business is from highly cyclical automotive and industrial end-markets, less cyclical consumer-driven soapy wastewater and non-cyclical landfill leachate comprise the remaining. Gotham estimated that the oily wastewater streams are most impacted in a recession since the real shipment value in these end-markets declines by 27.4% in a deep recession and 5.2% in a mild recession. However, wastewater volume drops relatively less than production activity, depending upon the severity of the recession. During a mild recession, small declines in production activity due to production line slowdowns or reduction of batch sizes lead to a minimal impact on wastewater volume generation. However, during a deep recession, severe declines in production activity due to idled machines or cutback of production hours lead to significant drops in wastewater volumes. Oil sales and processing revenues are driven by volume processed and decline in line with wastewater volume. However, the target's oily wastewater revenue is partially shielded from volume declines due to regular collection schedules and charges on a per-pickup basis. During recessionary periods, pricing and number of customers does not change, but there are lower levels of wastewater volume, leading to steeper declines in margins due to fixed plant and fleet costs.



Target Is Leader In Niche Industrial Wastewater Treatment, A Market With Moderate Growth

The target is one of two large players in an otherwise fragmented market. Since the industry is still evolving along the maturity curve, the target is well-positioned to achieve additional organic and acquisition-driven growth. Large manufacturers typically contract with broad environmental services players who either offer wastewater treatment services or contract with a wastewater treatment facility. While some of the environmental services players prefer mom & pop wastewater treatment players to obtain better pricing, others work with large players for the ease of doing business and peace of mind for safe disposal of their customers' wastewater. On the other hand, small manufacturers have direct contracts with industrial wastewater treatment companies or go through transportation companies and brokers. Gotham's interviews revealed that the purchasing process is increasingly driven by corporate EHS programs that seek more sophisticated vendors with their most important vendor selection criteria being safety, service, reliability, and response time. The trend toward more sophisticated players benefits the target as it is highly ranked by customers based on service, response time, and safety standards. As manufacturers seek efficiency and aim to reduce overall water usage, wastewater volume is expected to grow at a slower rate than production activity, but the target's sophistication and market-leading presence means it is well-positioned to capitalize on the EHS trend and grow its market share.

The Outcome: Gotham's oil price sensitivity and recession impact models allowed our client to gain clarity on potential margin risks. Our assessment confirmed the target's leading market position and potential for growth, allowing our client to price the deal accordingly ahead of its check-in bid.