

A Dynamic Water and Wastewater M&A Market – Perspectives From Industry Operators and Financial Sponsors

RECENT WEBINAR SUMMARY & TAKEAWAYS

The recent COVID-19 pandemic is magnifying the importance of the water sector in the municipal, industrial, commercial, and residential segments as they are viewed as “essential businesses”. Water is a necessary component for cleaning and disinfection related to COVID-19 in the home and in commercial settings and is receiving prominent attention in headlines. While the sector has gained more interest in the past few years and generated strong investor interest, recent events have accelerated and spurred additional focus on the sector and has confirmed that water and wastewater treatment products and services are an exciting area for investment. The McLean Group moderated a recent webinar panel and specifically addressed M&A drivers and activity with key financial and industry players. We have summarized the key takeaways as follows:

Water is an essential business

- Water and wastewater are still highly attractive from an investment point of view
- Not all water businesses are the same. Some will be more attractive and others less attractive
- Deals are getting prolonged or extended
- Valuations impacted - how to best determine the new norm? Is it a one-time event or a new norm?
- Deal structure is being more creative - may have an earn out to de-risk the project
- Innovation in technology will drive new opportunities
- Weak will get weaker and the strong will get stronger



“Despite the recent upheaval in the global markets due to COVID-19, water is still an attractive sector to be in long term”

- Mark Bertler

Valuation and M&A Drivers

- COVID-19 is having a temporary material effect on Q2 results and likely Q3, and investors and sellers alike are trying to determine the best way to address a “gap quarter” that was impacted by the disruption. Valuation is strongly predicated on financials and investors are feeling out the “new normal” as they make investment considerations. Near term future uncertainty is clouding the outlook for exits in the next 6-12 months.
- Valuations are bifurcated between companies with strong existing management and strong existing internal controls, and those companies that do not have the leadership and systems in place and are being forced to rethink business practices (i.e. having to retrench and make major operational adjustments to deal with the impacts). All companies are adapting and pivoting to address challenges, yet those with best practices can do so more easily.

UPCOMING WEBINAR...



LIVE WEBINAR
BUILDING HEALTH AND SAFETY IN THE PANDEMIC ENVIRONMENT

Building Design and Management
Tuesday, August 11 at 3:00 pm CT
- Scott Shaw, Head of Architecture, ARCO Murray
- Dwight Stewart, Co-Founder & CEO, Iger

Technologies and Tools
Tuesday, August 18 at 3:00 pm CT
- Mark Bertler, The McLean Group (MODERATOR)
- Anders Hallberg, Mazarine Ventures
- Marve Zaatar, Blue Box Air
- John Lovett, InstaScope

JOIN US: Tuesday, Aug 11th and 18th at 3pm CT



THE MCLEAN GROUP

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Valuation and M&A Drivers (cont.)

- Due diligence efforts are taking longer as web conferences become the norm and there is less in-person diligence. COVID-19 has pulled back the curtain on how resilient firms are in terms of people, product, process, and place (workspace), thereby providing a closer look at ability to survive hard conditions. The spotlight is really being put on CEOs and how individual company leaders react to adversity, which might not be as evident in steady state environments. This spotlight can provide a good indicator of how these individuals will deal with future challenges. So COVID-19 has essentially accelerated due diligence on the character of the CEO and overall corporate resiliency to adversity.
- In some transactions, investors are looking to de-risk deals by using earn outs or phased EBITDA targets in deal structures and share risk with sellers going forward due to lack of visibility over the next 6-12 months.
- Strategic buyers are identifying gaps in portfolios and opportunistic leaders will be acquisitive to fill those gaps. Companies will also be looking to incorporate vertical integration into their supply chains, especially larger providers. Diversification of end user vertical markets along with a view of selling to either residential/commercial or industrial/municipal sectors also play a role in the evaluation of acquisition targets. Those firms with better diversification have tended to fair better than those with singular end market focus.
- Private equity will likely appreciate the recession resistant nature of certain sectors in the water sector and have raised significant amounts of capital (dry powder) to deploy into exciting opportunities within the water and wastewater sectors.

Thoughts on Municipal, Industrial, Commercial, and Residential Segments

- **Municipal** – The initial pressure faced by municipalities was to both protect employees with the proper PPE and to ensure employee availability at facilities. This accomplishment ensures uninterrupted service. The issue facing municipalities today will be the impact from a shrinking tax bases due to COVID-19 impacts on employment rates and a freeze on non-essential economic activity. This results in a decline in overall water demand with specific impact in commercial buildings, the entertainment industry, and the majority of food service establishments. This revenue decline will put significant pressure on how to best allocate limited budgets. There appears to be more activity surrounding the use of “digital” solutions that enable municipalities to be more effective in driving data driven decisions on capital and maintenance spending.
- **Industrial and Commercial** - Industrial and commercial are experiencing many of the same trends and issues since some businesses are deemed non-essential and are forced to close and keep workers at home (hotels, entertainment sector, restaurants, etc...), while businesses that were deemed essential are experiencing a boom. In general, most essential industrial and commercial companies are surviving and even thriving during this time. The same initial challenges of providing a safe work environment for employees predominated the early actions of executives and owners.
- **Residential** – As consumers are sheltering in place, many are becoming more self-resilient in that there is a reluctance to have services professionals in the home setting. Therefore, consumers are implementing upgrades and improvements to their home water infrastructure on their own accord or simply putting off the decision to purchase or rent water treatment equipment. E-commerce firms are flourishing as more consumers are shifting their buying behavior to this channel. The purchase of water treatment products tracks closely between those states that are closed down for business and those that have maintained a more open approach to allowing businesses to operate. Similar to the increased demand of digital solutions in municipalities, there appears to be strong interest in all things digital including a variety of smart home water initiatives (leak detection, filtration, hot water, drinking water, irrigation, water appliance, sump management) and how these initiatives tie into the IoT home infrastructure.

On Demand Webinar



Mike Reardon
USFilter, Culligan, PE
Water Industry Executive



Alex Loucopoulos
Sciens Water
Partner



John Robinson
Mazarine Ventures
Partner



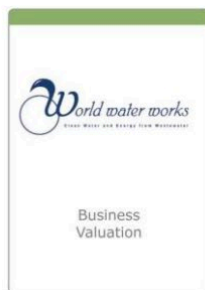
Mark Bertler
The McLean Group
Managing Director

Watch Now!

Trends and Sectors of Interest

- **Smart Home Initiatives** – Numerous technologies that permit the collection and analyzing of data are driving a burst of new possibilities within water and wastewater. This includes the development of new inexpensive sensors to provide real-time leak detection, water quality assurance, and water usage monitoring. These technologies are often smart phone enabled so that homeowners and commercial property owners can conveniently manage water.
- **Predictive Analytics and Condition Assessment Technologies** - Tools and innovations that enable owners, operators, and end users to get more visibility into risks associated with capital and operating expenditures help address these items before they become major issues or they can drive better decision making as to how to deploy limited budgets. Many of these tools have been evolving over the past several years, but COVID-19 has accelerated demand for some of these technologies. In the municipal sector, condition inspection and other software-enabled assessment technologies allow operators to evaluate and monitor assets remotely. In the not so distant past, facility operators would need to go to do physical inspections of infrastructure components (including filters, pumps, digesters, and clarifier tanks), but now these same operators can leverage software analytical tools to better address pending or current issues and address appropriately.
- **Subscription Models** - Today, consumers are more likely to embrace rental and leasing subscription models to obtain the latest and greatest technological advancements for their home. As with other industries, the adoption of the subscription business model is becoming more commonplace through equipment rental/sale with monitoring to track usage, leak detection and performance. The above mentioned predictive and condition assessment technologies are making these models economical for subscription service providers.
- **Consolidation** - Investment in the water sector has been strong over the last 10 years and there is no shortage of smaller companies offering innovative and evolving solutions. The expectation is that there will be continued consolidation along with more aggressive water companies pursuing tuck-in acquisitions to accelerate new or existing market presence, expanded technology product offerings, and business synergies.
- **Introduction of Longer-Term Oriented Capital** - The water industry has had solutions in place for exceptionally long periods of time and there is some degree of resistance to change. But as more progressive generations transition into the water workforce, innovation is beginning to take hold. This dynamic can cause investments to take longer to harvest. So longer term oriented capital will be able to invest early and realize the ground shift changes in the industry as it adapts new technologies to deal with modern issues.
- **E-commerce**- Direct to consumer and internet focused distribution models are experiencing a strong upward spike as consumers shelter in place and their buying habits shift into online purchases. These trends are turning a previously untapped, technology resistant base onto the ease of online transactions, and this is likely to stay in place for a long period. Additionally, there is a new generation of consumers who have grown up with online purchasing and buying things in a different manner than previous generations. As this new generation continues to age into the homeowner decision maker demographic, e-commerce is expected to have a stronger presence in channel distribution.

SELECTED TRANSACTIONS



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