

MERGERS & ACQUISITIONS

Sandy Aftermath Creates Deal Opportunities

Middle-market buyers may circle targets in infrastructure, water management and waste systems

By PAUL GOLDEN, Schilling Ventures

December 22, 2012

Print

Print

Reprints

Comments

Much of the Northeast is still working through the aftermath of Hurricane Sandy; the second "hundred year" storm in the last ten years. What silver lining in opportunities does this represent for buyers, builders and sellers of companies? For those involved with water, waste systems and infrastructure, the immediate and long-term opportunities are vast. First, a few statistics:

* Ninety-seven percent of the Earth's water is salty and two percent is locked in ice and snow. That leaves only one percent easily accessible for industrial and human use.

* Of the accessible water, two-thirds of the world's population either has zero access or inconsistent access to clean and safe water.

* Of the \$600 billion spent on stimulus, not a dollar was spent shoring up the storm surge defenses of our most populous city - New York.

* Between 1970 and 1990, U.S. municipalities spent approximately \$100 billion in new water and wastewater systems. Today, most of that infrastructure is at least 20 years old, and much of it is closer to 40 years old.

* In our largest and oldest cities, such as New York and Chicago, much of the underground infrastructure dates back to the late 1800's.

* The EPA, Congressional Budget Office and the American Society of Civil Engineers estimates the U.S. must spend a minimum of \$500 billion during the next 20 years on water and wastewater infrastructure. A study by the American Water Works Association puts the figure closer to \$1 trillion over 25 years.

So what does this mean for operators and buyers of companies?

For short-term focused firms, there is an opportunity to win service contracts related to water and





waste systems. These contracts tend to be "sticky," but with highly competitive processes. Assuming the general contractor performs well, they develop trust and generally get a last look on the next bidding cycle. Under the general contractor, multiple discrete suppliers gain access as subcontractors. For middle market buyers, there are literally thousands of these subcontractors. In addition, there are providers of consumable products, from chemicals to filters and other wear parts.

Long term, the infrastructure, service and recurring revenue streams are tremendous. The under investment of the past five years as a result of the recession -- and the likely continued under investment for the next two to three years until fiscal conditions improve for municipalities -- means demand should explode in 2015 and beyond. Given lower results of the past five years and the tough near-term forecasts, this should provide for lower valuations for available companies.

In addition, the devastating impact of Hurricane Sandy should lead to more rigorous standards for construction, and greater investment in systems that can handle storm surges. These investments will likely include not only design additions, but completely new systems that make current systems obsolete. The result will be less retrofitting of existing systems, and greater Greenfield building of sewer and waste water systems. For example, since Hurricane Katrina hit in 2005, New Orleans has seen expanded capacity through larger sewer systems and a greater number of run-off areas to handle storm surges.

So where, specifically should buyers look? Four segments come to mind:

1. Follow the major players. Tervita, Veolia, Halliburton and several others provide turn-key solutions for wastewater conditioning. Each provides design-build work for municipalities in addition to operating services post-facility commissioning. In each phase, they rely heavily on subcontractors. These subcontractors provide pumps, control systems, sensors, chemicals and fabrications, among other features for both the physical infrastructure as well as ongoing operations. Most of these subcontractors are squarely in the middle market.
2. Look to regional service and product suppliers. Clearly coastal regions are the most affected, but don't overlook inland areas such as Chicago, which experienced 20-foot waves coming off of Lake Michigan during Hurricane Sandy. Much of the equipment provided to wastewater systems is large and difficult to ship, thereby driving local sourcing. Likewise, providing services remotely is difficult, and at a minimum, requires local presence for delivery of those services. Construction service providers tend to be local, such as concrete suppliers. Moreover, facility construction tends to take a long time, leading to long run and steady demand.
3. Look to adjacencies that can be leveraged to access the water market. Products typically used in the oil and gas industry are also ideally suited for wastewater. Case and point, products designed to transport, filter and recycle heavily contaminated oil and gas extraction can do the same for wastewater. Another area overlooked post-Katrina was in mobile temporary housing and command centers. The same surge in demand for these products is happening in New York and New Jersey post-Sandy.

4. Look to Lowes and The Home Depot for guidance on products experiencing an uptick in demand. The rebuilding of New York and New Jersey will take years, particularly when considered from a residential perspective. From flooring to HVAC systems, hundreds of thousands of homes are in need of repair and reclamation. This could create additional investment opportunity for dealmakers within the industrial and building products space.

Regardless of super storms, the age of the United States' overall infrastructure will demand investment. While government budgets will be a constraint on this investment, politicians favor the job creation that comes as a result. Additionally, there are more than 20,000 wastewater and water treatment facilities in the United States alone. However, according to Marketline research, while the U.S. represents 18 percent of the global market, both Europe and Asia represent 30 percent each. Particularly in Europe, infrastructure is aged and in need of upgrading.

With all things considered, the addressable market for products and services, both locally and globally, presents a tremendous opportunity for middle market companies.

Paul Golden is the founder and managing partner of Schilling Ventures, an investment firm in Naperville, Ill. that buys and partners with industrial businesses.

For more information on related topics, visit the following:

- Infrastructure

©2013 Mergers Unleashed and SourceMedia, Inc. All rights reserved. SourceMedia is an Investcorp company. Use, duplication, or sale of this service, or data contained herein, is strictly prohibited.