How to Increase the Strategic Significance of your Business

Waste management entrepreneurs have an innate ability to create strategic businesses when they are incentivized, long-term oriented entrepreneurs with the fortitude to make a collection of strategic decisions based on their unique market knowledge. The best entrepreneurs succeed in creating difficult-to-replicate assets for which strategic acquirors are willing and able to pay a strategic price.

By Michael Castellarin, Riley Webb, and Davey Mishra

WHAT MAKES A BUSINESS STRATEGICALLY SIGNIFICANT? We think it is a collection of characteristics that make a business difficult to replicate in an attractive market that acquirors strongly desire (or ideally, need) to operate in. Entrepreneurs and executives in the waste management industry can often find themselves preoccupied and focused on growing their business' near-term bottom line, which can lead to missing opportunities to grow the strategic significance of one's business, and, ultimately, the business' value.

There is no overnight shortcut to creating a strategically significant business. It is built through a series of strategic decisions, or calculated bets, based on a business' assets, capabilities, and where the market is going. Interestingly, these strategic decisions may decrease EBITDA in the short term, but accelerate growth in revenue and earnings longer term. In this article we will lay out several ways, based on our experience, to increase the strategic significance of a waste management business.

A Market Leader

Clairvest's prior investment partnership with Scott Earl and County Waste of Virginia is a prime example of building a leading market share player. Both organically and through acquisition, the organization built significant density and expanded its market share to become the leading player in the greater Richmond, VA market in a short period of time. This was a significant contributing factor (along with successfully executing on some of the other points raised in this article, including vertical integration), which led to a successful sale transaction to GFL in 2020.

Photo courtesy of County Waste.

Create a Leading Player in Attractive Markets

Not all markets are created equal. The demographic and economic dynamics of the geographies a business operates in will have a significant impact on its growth rate. Similarly, the disposal environment (i.e., the capacity of, and diversity of, disposal alternatives) and nature of competition in one's market will have a material impact on profitability. To the extent possible, expanding one's reach to grow in adjacent, higher growth areas will boost revenue growth and the attractiveness of one's business. Reaching farther afield to expand in non-contiguous geographies may be worth the additional risk and complexity; however, strong local management is imperative and gaining sufficient scale (revenue and route density) in the new market to afford the necessary overhead must be a priority. To become strategically significant, we have found that for logistics/services businesses such as waste management players, it is very important to be a leading market share player in one's markets with dense collection operations **(see A Market Leader Sidebar, page 35)**.

Increase Leverage Through Vertical Integration

Vertical integration occurs when waste management companies internalize a portion of their collection volumes to owned/managed transfer stations, material recovery facilities (MRFs), and/or end-disposal sites (collectively, "post-collection assets"). Owning or operating a landfill, which is increasingly challenging in most markets, is not essential for achieving material benefits from some vertical integration. In certain markets, owning recycling facilities and/or transfer stations with good end-disposal options can be just as valuable. These hard-to-permit assets allow you to gain additional margin from your collection volumes. They can also be useful when negotiating better disposal rates with landfill owners. This is not to say that transfer stations or MRFs are always the highest margin segment of your business. These operations may actually have lower margins than your collection operations, especially in markets with robust disposal options, or in markets where diversion requirements make processing waste more expensive. However, these permitted facilities often play a pivotal role in making collection operations more efficient and, therefore, a portion of one's collection divisional margins are, in fact, attributable to such facilities.

Post-collection assets have become even more challenging to permit in recent years for a myriad of reasons, thereby making greenfielding a new facility an onerous challenge. However, well respected local entrepreneurs can be positioned nicely to succeed with permitting due to their long-term ties to the community. Alternatively, most major markets have numerous small scale post-collection assets serving specific sectors/areas. Acquiring a smaller facility and expanding its permitted capacity, while still challenging, is an alternative that can accelerate the timing and increase the probability of success. Volumes always gravitate to the lowest cost disposal outlets. When assessing the growth of a transfer station (greenfield or acquired), it is important to understand volume trends, prices, and the facility's differentiation (e.g., shorter drivetime, turnaround time to tip at the facility, impending landfill closures, etc.). Adding post-collection assets in proximity to one's collection operations is challenging, but often a way of materially increasing the defensibility and intrinsic value of one's business beyond the incremental EBITDA contribution **(see Developing Post-Collection Assets sidebar, page 38)**.

Avenues for Growth

DTG Recycle, a company Clairvest previously partnered with, operates in the greater Seattle, WA area in a franchise-driven MSW market. Critical to DTG's success and growth was expanding on its leading market position as the #1 C&D collection and recycling company to offer additional recycling services to commercial and industrial customers. DTG also expanded into adjacent lines of business to better serve its customers, including greenfielding a portable toilet rental and service division. Lastly, it acquired a composting site to address the increased importance of organics diversion in the market, providing another avenue for growth.

Photo courtesy of DTG Recycle.

Focus on Building a Healthy Mix Between Recurring and Non-Recurring Revenue

A company's quality of revenue is equally, if not more, important than the size and margin profile of the company. Recurring revenue lines of business (e.g., commercial and residential collection), which are typically more stable, will be valued higher than "re-occurring" or one-time revenue (e.g., temporary roll-off). In our experience, to understand the "stability" of one's revenue, acquirors will dive into this type of analysis. Is customer attrition in your recurring revenue lines of business acceptable, especially during periods of price increases? Are you winning customers on price, or service? What percentage of your customers are under contract and are the terms industry standard? Are the margins industry leading? However, building density and a strong market position regionally will also typically involve growing other lines of business that are less stable, such as temporary roll off. These additional lines of business can leverage one's strong brand, SG&A, and transfer and recycling facilities. The vital part is actively managing the mix between the different lines of business and not allowing the least stable, lowest value lines of business dominating your revenue mix and management bandwidth.

Meet More of the Customer's Needs Through Additional Services Offerings

The traditional purpose of a solid waste management business is to collect and manage waste dependably and safely. A foundational building block is being reliable in collection service. However, the best entrepreneurs and executives realize that customer needs are changing. Increasingly, customers are looking to their waste management service providers to do more than pick up their waste. They are looking for help in achieving their corporate, municipal, or sustainability objectives. This is both an opportunity and a threat. Companies that succeed in building out these capabilities will grow their revenue per customer and improve customer loyalty (and decrease attrition). Companies that do not will face increased competition and may lose valuable customers even if their service is priced attractively (customers often want a single service provider). Making this transition is challenging. It requires a cultural shift within the organization to becoming a metrics-focused diversion and sustainability business, along with necessitating new assets and capabilities. Setting up recycling facilities is capital intensive and time-consuming. Finding trusted partners initially and starting with a smaller, more focused, and manual operation are ways of reducing the upfront capital required. In our experience, companies who succeed at diversifying their service offerings see their success reflected in the business performance (higher revenue per customer, higher revenue growth rate, lower churn, higher margins), and improved strategic value at exit **(see Avenues for Growth sidebar)**.

Build a Competent, Complementary Team to Accelerate Growth

At some point, every business will reach a certain scale where an owner-operator cannot run the day-to-day operations and continue growing the business with the same degree of success. The size at which this occurs varies from business to business. However, to grow a strategic enterprise, building a strong senior management team that possesses diverse talent that complements one another is vital. We believe there are at least three valuable areas for management investment to assist entrepreneur CEOs: 1) operations, 2) finance, and 3) sales/customer support. It is possible to survive with very talented site/business unit managers, but a capable Vice President of Operations or Chief Operating Officer can be even more effective in reducing the number of daily operational fires that need to be fought. A strong Chief Financial Officer is critical in establishing a metrics-focused organization. This position can be especially challenging to hire given the number of different hats they need to wear—IT, insurance, accounting, banking, and sometimes HR. The best CFOs are not just detail-oriented, but also strategic thought partners on acquisitions and capital investment opportunities. Lastly, customer sales and support are essential functions to successfully grow. Increasingly, we believe the sales and support leader must be analytically sound and numbers-oriented and we would value that above direct industry experience. In building one's senior team, it is vital to ensure alignment with your company values and with whom the CEO can trust to have direct, frank, and transparent communication. Tap into your networks, engage recruiters, and be patient; finding the right person is challenging. Keep in mind that all three of these hires are an investment—you are unlikely to see a return on these additions in the first year. If you are truly successful in building a strong management team, you will give strategic acquirors another rationale for buying your business.

Long-Term Oriented Owners Build Strategically Significant Businesses

Waste management entrepreneurs have an innate ability to create strategic businesses. To some, this may be a surprise given the dominant market positions of the large strategic waste management providers. To us, it is a natural phenomenon when you have incentivized, long-term oriented entrepreneurs with the fortitude to make a collection of strategic decisions based on their unique market knowledge. The best entrepreneurs succeed in creating difficult to replicate assets for which strategic acquirors are willing and able to pay a strategic price. | WA

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Clairvest's mission is to partner with entrepreneurs and management teams to help build strategically significant businesses. Founded in 1987 by a group of successful entrepreneurs, Clairvest is a top performing private equity investment firm with ~$3.5 billion of capital under management. Clairvest's experience in the waste management industry spans more than 17 years across eight platform investments. Clairvest's management partners trust their ability to support them through their most important milestones as they grow their companies, take on new challenges, make acquisitions, and build their legacies. Clairvest is proud of their positive track record of helping our partners create value for all stakeholders. They love building businesses and helping entrepreneurs succeed. Reach out to Clairvest if you want to discuss this article, their experience in building strategic businesses, or experiences with your own business. For more information, visit www.clairvest.com.

Developing Post-Collection Assets

Clairvest is proud of its long-standing equity partnership with Winters Bros. Waste Systems of Long Island; the company is Long Island, NY's leading solid waste management company, and its strategic asset base demonstrates the importance of vertical integration. In addition to its extensive collection operations, the company has acquired or built a network of MSW and C&D transfer stations (which also perform significant recycling activities) as well as a highly efficient and effective dual stream residential MRF. Winters Bros. Waste Systems' hard to replicate network of permitted transfer and processing facilities also include two recently acquired waste-by-rail locations and these assets will become increasingly important to transport waste materials off of Long Island in a safe and environmentally sustainable manner.

Photo courtesy of Winters Bros. Systems