

Companies have also needed to rethink their inorganic growth strategies for the time being. M&A has been a consistent driver of earnings growth within the sector, but until there is more clarity on the duration and severity of the COVID-19 impact, it is difficult to envision significant or transformative M&A transactions in the near-term that are not driven by a distressed seller. Most active sale processes have gone on hold and most sellers that were planning to come to market have decided to delay until there is more clarity on financial performance and valuation.

EBJ: What impact will COVID-19 have in the environmental industry?

Nayak: The environmental industry is typically a late-cycle outperformer with population increases, housing starts, and new business formation being good leading indicators of industry growth. In addition, environmental subsectors have historically outperformed other industrial sectors through recessions – for instance, the environmental consulting industry declined just 3.2% during the Global Financial Crisis between 2008 and 2009, and the municipal solid waste sector actually grew in five of the last six U.S. recessions. That being said, the recession that has been caused by COVID-19 has so far resulted in a more compressed downturn compared to the Global Financial Crisis, causing companies exposed to commercial, oil & gas, and transportation end-markets, or with project exposure, to experience steeper declines in revenues and making it difficult to concurrently adjust their costs.

While initially there was hope that a return to normal GDP growth would be quick, most strategists agree that we are likely looking at a longer path to recovery as social distancing measures continue. That said, the federal government continues to spend meaningful dollars in bipartisan stimulus packages to support individuals, the economy, and the financial markets. Ultimately the environmental industry will benefit, as it has in prior recessions, from support that is provided by the federal government in the form of spending on infrastructure, including in funding for broadband, water systems, roads, and public transit. ■

SANDBERG STRESSES THE IMPORTANCE OF MANAGEMENT PREPARATION AND INTEGRATION PLANNING TO SUCCESS IN M&A

Sandberg Consultants is a business consulting firm that assists in transitions of small- to medium-sized environmental, geotechnical, and engineering firms. Sandberg Consultants has assisted multiple firms on the buy side to grow or on the sell side as an exit strategy including locating potential target firms to providing valuations, integration, and creative solutions to complete a sale or purchase. Clients include Environmental, Remediation, Engineering, Geotechnical, and Drilling firms across the US and Canada from New York and Florida, to Colorado, Nevada, and California.

Derrick Sandberg, President. Mr. Sandberg has worked in the geosciences and business management for over 25 years beginning in the field as a Geophysicist, then transitioning to management and eventually owner of two environmental firms. Derrick sold his last company to Cascade Drilling as their first purchase in 2011 and then assisted Cascade in the purchase of additional firms for over 3 years before founding Sandberg Consultants.

EBJ: What's been the flow of new companies coming to you to seek valuations? What type of companies have been looking for your expertise? Have they been new growing firms, are they looking for ownership transitions, what are they looking for and what type of assistance do they need?

Sandberg: Recently, due to the Virus situation, activity has slowed. We are still actively working with a few firms but many of them requested a “pause” for a few months to see how the market plays out. Most of the firms we are currently working with are environmental, geotechnical, and engineering.

One of the first items a company requests is a valuation of their company. The companies are either sole ownership or multiple owners that would like a general idea of their value to potential purchasers. On the buy side, we provide valuation ranges of prospective targets by reviewing the financials including any reasonable adjustments to a company's earnings. Similarly, on the sell side, we review financials and recommend reasonable valuation ranges.

Until recently, many of the mid-sized firms were looking for new purchases or their first purchase to grow their business. Most are now, understandably, cautiously reviewing or “pausing” the purchase of target firms as it is not only new territory for

them, but now have the potential issue of overextending themselves.

Firms looking to sell have been in the industry for many years, and have successfully grown or maintained their business, but are looking to transition out for eventual retirement. We advise firms to discuss and review potential sale options years in advance because of the time it takes to not only find an interested party, but also the need to stay with the new business for 2-3 years to transition and integrate their clients, know-how, and other operations.

EBJ: With all the consolidation that we've seen in the industry over the last decade or more, how would you say the challenges have changed for the small or for the mid-size company in the consulting engineering industry?

Sandberg: With the consolidation it is becoming more difficult for the mid-sized firms to find a smaller firm with a good fit. Similarly, the larger firms are seeing their mid-sized firm purchase options decrease. For the small and mid-sized firms looking to sell, they appear to have a larger pool of firms to choose from. However, there are some firms that are now digesting (integrating) their purchases and are on hold for further purchases.

EBJ: Data indicates that internal growth is substantially higher in small and mid-sized firms. Do you find this

is true and what client sectors or client preferences are driving this?

Sandberg: It is only natural for small to medium-sized firms to grow at a higher rate than a large firm. As a percentage, it is much easier for smaller firms to grow. However, there are still many small firms that have remained relatively small for many years. They find a size that works for them and their market with small year-to-year growth changes up and down, but in general stay at a similar relative size. The mid-size firms are tending to have more internal pressure to grow so are looking outside organic growth to expand their business.

EBJ: What operational issues are these companies struggling with most and how do you suggest they overcome them?

Sandberg: One of the most common issues is integration. On the buy side, it is very important to fully understand the operations and culture of the firm they are purchasing. The more they understand the operational procedures, client relationships, and internal culture, the better the integration. Interviewing in depth all the mid to upper-level managers is important to get a feel of the management style, expectations, and operations.

EBJ: Which are some of the obstacles that small and mid-sized firms encounter while trying to achieve their growth goals?

Sandberg: As with most firms, personnel are what make the company. Until recently, many of the firms we are working with would hire key positions to help grow the firm. But with the tight marketplace (as of January), firms are looking to purchase another company to inherit the whole group of employees. The hope, of course, is to bring on a high percent of solid performers in the group of employees with the purchase.

Other typical issues with a small firm include revenue fluctuations year over year resulting in hiring and laying off personnel year over year. They are slow to hire and then slow to lay off resulting in inefficiencies. In addition to personnel issues, man-

aging cash flow for operations can be challenging for small to medium sized firms. There is a delicate balance between growing quickly and experiencing cash flow issues and expanding in a controlled manner that works for the company.

EBJ: What will be the pace of M&A activity in the environmental industry for 2020 and 2021?

Sandberg: With the current uncertainty, it appears that M&A activity will slow for the rest of 2020. If the economy begins to re-engage, 2021 will most likely show more M&A activity. The rate of activity will most likely follow the general rate of economic activity. For those firms that have a solid base, acquiring a firm(s) may be a good opportunity. Rather than the recent seller's market, the tide will most likely turn to being a buyer's market.

There will be more risk on the seller's side as the buyers will be more cautious and if/when they do buy, it will be more on their terms. In the past year, sellers tended to have more of the advantage because of the smaller pool of firms selling. Some of the ways to continue to engage firms in M&A activity will be stretching out earn out terms to reduce the risk of the acquiring firm, as well as more liberal escape clauses should the economy not pick up.

EBJ: Which type of deals are more likely to meet expectations? Which type of deals are least likely to meet expectations? Which obstacles lead to deals failing to achieve expected value?

Sandberg: The more thorough and transparent the firms are with each other, the more likely they are to meet expectations. Surprises and unknowns muddy the integration deal. The best deals are where both firms are honest and transparent about all their issues so that there are few to no surprises during purchase/sale and integration. Very thorough due diligence and reasonable expectations from buyer/seller is the best. This includes in-depth discussions with employees about their desires/expectations from the transition and interesting incentives for the selling firm's employees to stay on and be excited about the potential new opportunities. Of course, providing ownership possibilities to key employees is one way to keep those important employees engaged in the success of the combined firms. Additionally, both firms need to agree on their business strategy for the 2-3 year period of the possible earn-out. By having a detailed business/financial plan in place and common future goals enable the firms to become more successful in the transition and integration process.

EBJ: Are there any particular regional market or M&A variations you observe?

Sandberg: There seems to be more interest on the buy side for firms in Southern California. There is also interest in the SF Bay Area, Sacramento, and Pacific Northwest. There is limited interest in Las Vegas and Reno. There is more interest in expanding into Texas and Florida, but So-Cal seems to be most in demand. Those wanting to sell are in each of the markets – no one market seems to have more firms wanting to sell. □

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