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COMPANY DEEP-DIVE

Former VP at GO Car Wash Sees Growth Opportunities in Skilled Labor and Technical Services Despite Industry Challenges

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PRIMARY COMPANY

GO CAR WASH

Summary

The client engaged in conversations with an expert regarding the challenges and complexities faced by the car wash industry, including valuation methodologies, market dynamics, and the impact of public company valuations. The expert highlighted the importance of aligning internal company valuation with potential exit multiples, market saturation, and careful selection of merger partners. Additionally, the expert discussed the financial health of the facility exterior services sector, emphasizing the opportunities for growth in related service lines that require skilled labor and technical expertise.

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INTERVIEW TRANSCRIPT

Client 00:00:00

Thank you for taking the time to chat about the M&A component of the car wash market. Just what you've seen and how the market's evolved and then where valuations are. More specifically, maybe it's more so about the M&A methodologies and how companies are valued, real estate versus opco, that type of thing. I do have your profile here, but maybe just two quick questions on your background. Number one, I saw you, I think you left in January 2024, but how long were you in the industry? Any color you can provide on GO Car Wash, what you guys were focused on I think would help to guide the conversation.

Expert 00:00:37

I joined GO Car Wash in December of 2020 to head up the M&A function for the team there. We were just still assembling our executive leadership. We had our CEO, CFO, COO, and I was employee number four in Denver. We were about 35 locations when I joined at that point in time. The platform was established in May of 2019 under Imperial Capital sponsorship. Imperial's a limited market PE out of Toronto. They bought two operators in the Kansas City market as the initial platform investments, and so Kansas City became the first geographic market for the business.

I joined on, we had 35 locations at that time, I think we had expanded into Las Vegas and then Texas, into the San Antonio market and Corpus Christi, Texas markets, so still just a growing and building consolidator at that point in time. In the subsequent 18 months, we completed 21 acquisitions and built the company up to about 150 locations, expanded into some additional geographic markets, Southern California, Oregon, the Valley of Texas, so down along the Rio Grande Valley, Harlingen, Brownsville, Laredo, those areas, Virginia, and up and down Virginia, Fredericksburg, Richmond, out to the coast of Virginia.

We went to upstate New York with a pretty sizable operator up there acquisition that got us into Buffalo, Syracuse and Rochester markets. Quite a bit of flurry of M&A activity and growth during that span. Things cooled in the summer of 2022 with inflation and all the other things in the economy that caused consumers to pause on discretionary spending, especially the $15 car wash. We pulled back on our M&A strategy with the cost of capital and those dynamics.

It quickly became a disconnect in the market between seller expectations, which had been driven up to that point with all the flurry of acquisitions, not only by us, but others, and then what buyers now were willing to pay just given the economy and what was going on. At that point we shifted to more of a greenfield strategy. For the next 18 months or so, that was my focus until departing in January 2024. That's the broad brush summary on it, but we can dive into some of those parts.

Client 00:02:54

Very helpful. Just to clarify I understood, you said in 18 months, you completed how many acquisitions?

Expert 00:03:00

Yeah. We did 21 acquisitions, so quite a frantic pace. Some of it was pretty small. It was all over the map. Like the one that I mentioned in upstate New York, Royal, that was a 14-site acquisition. The Valley of Texas we purchased, let's see, 2020. Let's see, how many were operating at the time?

Probably 2018 were operating at the time, but there were seven to 10 in development that were part of various stages of being built that were part of the acquisition, so 25 is what we called it, 25-unit acquisition. With that one, those are the two larger ones we got done. There certainly were a handful of just one ops or one or two-site operator. We bought an eight-site operator in Austin was another fairly good-sized business. It was all over the map, but few big ones and a lot small ones.

Client 00:03:50

What's average EBITDA per site?

Expert 00:03:52

The average EBITDA would be anywhere from as low as $300,000 up to $1 million. Probably the average was around $750,000. It's what we would model.

Client 00:04:02

Does that include a rent expense or not?

Expert 00:04:04

Yes. That would be rent-adjusted EBITDA. Oftentimes, the owner of the business would own the real estate and may or may not be charging the operating company rent. We often would be bidding on EBITDAR, which was a new term to me, which is pre-rent EBITDA. We would look at it as EBITDAR on the multiple and then EBITDA post rent. We would typically flip the real estate in a simultaneous transaction to a REIT. I was charged with making sure we got those two transactions to line up and close at the same time. It's working with our REIT in the background while we were working due diligence with the seller and making sure the timelines were syncing up.

Client 00:04:45

Okay. It was interesting hearing about the life cycle of the car wash industry. We've been following it from afar. We saw how hot it got and then it seemed to cool off. We weren't seeing as many car wash announcements over the past, call it, two years. Would love to hear where were valuations in 2021 and where are they today, in your opinion?

Expert 00:05:06

Yeah. It was a crazy run up. I remember when I joined in December, we were in the midst of negotiating a transaction with a seller and we were wringing our hands. It just really got crazy, nearly doubling from that initial deal that I looked at in December of 2020. People were paying like 15X and Q1 of 2022 was probably the peak of the frothiness.

It got really crazy with all the private equity sponsored businesses coming into the space and everybody chasing the same strategy to consolidate. There's certainly a lot of fragmentation but a lesser number of quality operators that folks were running up multiples to try to get.

Client 00:05:46

It's pretty crazy. People paying up to 15X for a single site. Is that typical or was that just an anomaly? What were the more typical valuations you were seeing in 2022?

Expert 00:05:57

People were paying 14X, 15X, 16X. There was one that we paid up-front, we always would have some back-end synergies or drivers that would bring down the net multiple over time. For example, the Austin one, we contracted with the owner there who a lot of these guys were really developers at heart and not really a great operator. Their blood was in development, and so we contracted with a lot of owners, not just the Austin guy, to stay on and build additional sites for us in the geographic area where they were.

That was the case with Austin. We had four forward sites that we contracted with him to go out and find and build for us. The costs of those sites were certainly less than the multiple we were paying on the operating sites. In the future backwards to the blended multiple, once we had those sites, it would certainly buy it down quite a bit, two or three turns or more than that in some cases.

Client 00:06:54

Got it. That was the peak 2022. Where were valuations when you left in 2024?

Expert 00:07:00

Yeah. When everything reset, at least in our minds and most buyers' minds, we were trying to anchor back around 9X-10X, but did not find, again, many sellers willing to transact at that. Just one or two or six months earlier, their buddy sold for 15X, and so everybody still had stars in their eyes certainly through the rest of 2022 and then even through most of 2023. At that point it was time to shift strategy and we focused on greenfielding. It was not just because sellers had this disconnect on valuations. It was also because our businesses were flatlining and not growing because of loss of sales in the retail portion of our business of a one-time car wash user.

At that point we had over 50% subscription sales from subscription members and then 1/3 of it from retail users. When the retail users got soft in terms of demand, then we were trying to fix those operational issues and trying to figure out marketing strategies to drive more volume from the retail segment, which was always a target to be a subscription member. We wanted to make sure we didn't lose too much of that volume to then drive additional mix in subscriptions.

Client 00:08:14

Did the subscription piece hold up better?

Expert 00:08:16

It did. It proved to be pretty resilient even before, even at the time I was joining. Still the effects of COVID were being felt through the COVID downturn. Subscriptions seemed to hold up at least better than retail users for sure. We didn't see much drop off in 2022 from subscriptions like we did in the retail side.

Client 00:08:36

Helpful. I think you said you were trying to acquire companies for 9X-10X but not many takers. Have you heard anything about more recently in 2024, were transactions getting done and if so, at what price?

Expert 00:08:49

I think it's still tough to find users or to find sellers that are willing to transact. I think there's maybe been one or two type transactions, but not that many even. I don't think GO is another one. Since I left, I haven't really seen others do much certainly like it was back in 2021. It's just been slow to recover.

Client 00:09:10

Do you think that's just still because of the disconnect between buyers and sellers, or do you think.

Expert 00:09:16

The other big driver is everyone was anchoring against Mister's valuation, which obviously was the only public comp that we could rely on. Driven certainly was public as well, but harder to parse out performance of just the car wash business within that parent. As Mister's in that 2021 frothiness, Mister's PE ran up to I think what, 25, 26 at one point. Us mid-sized consolidators, we're all thinking we were worth high teens, if not 20X because of the discount against Mister.

Once that all changed, which was driven by Driven when they had curiously, their CEO, I can't remember which quarterly call it was, but I think it was in the fall of 2022 and he just declared car wash basically dead and just was very negative on the car wash business in that earnings call. Their stock tanked and then as a repercussion, Mister stock tanked and then was down trading 7X-8X versus the 26X or whatever it was at the height. When that all cratered, that also certainly caused us to rethink what we were willing to pay and then what is our comparable market value and those types of things. That was another big piece that changed perspective certainly on M&A.

Client 00:10:30

What earnings call was that, what quarter?

Expert 00:10:32

I want to say it would have been, I think the Q2 call that would have occurred sometime in the fall of 2023 for Driven.

Client 00:10:40

Why did he say car wash is dead?

Expert 00:10:43

They were struggling to operate that business and just didn't have good management. It's my perspective that at the top they really understood the business and they had grown too quickly. They're an international business. They had 1,000 car wash locations over in Europe and other places. In the U.S. I think they had 200 or so at that time, and I don't know. They lost focus. After that call they started shopping like 27, 28 underperforming sites trying to find a buyer to offload those two. We looked at that portfolio and I know others in the space looked at it as well.

I don't think anything ever materialized because if you got a site that's a dog, there's not much you can do to turn it around with a new owner. Anyway, they just had a lot of operational problems that caused them to sour on that business among all their other brands and businesses across automotive services space.

Client 00:11:37

Talking about valuations today, you said you had not many big platforms getting done, but maybe one to two site locations transacting. What do you think those are trading for these days? What multiples?

Expert 00:11:49

Yeah. I'm sure they're probably getting done somewhere in the 8X-10X range. I don't think anyone's paying low teens like it had gotten to a couple, two, three years ago. Part of the problem is with inflation, not only did it affect consumers, but it affected cost of capital, obviously, but as well, real estate was getting bid up at that time. We're competing for plots of land in key retail hubs in a city or a suburb against Starbucks and Chick-fil-A and all these other folks who want to get into that space. Real estate became a lot hotter and more expensive for a site. Cost of construction, if you were doing a greenfield, got bid up. All the trades were 20% and 30% higher at that time.

Cost of equipment from the car wash equipment manufacturers had gone from you could get a package for $800,000 and now it was $1.3 million. Everything just got expensive, and so even trying to find sites that made sense for a greenfield was challenging if you were trying to adhere to any kind of a reasonable return on investment or hurdle rate. Everything grinded in terms of growth both on greenfield and M&A.

Client 00:12:59

Interesting. I want to talk about valuation methodologies, maybe just walking me through how car washes are valued. First question would be, when people are talking about these multiples, like you said, 8X-10X for one to two locations, does that typically include real estate or not? Do people, when they're talking about valuations, included our, as a rule of thumb donors?

Expert 00:13:23

Usually, that was what we call the gross multiple. That was the EBITDAR multiple pre-rent. The EBITDA multiple would then be, let's say if you had a 12X gross, it'd be maybe 8X or 9X net. We talked in terms of that, gross multiples before rent and then net multiples after rent.

Client 00:13:40

The gross was 8X-10X. What was the net?

Expert 00:13:42

I was saying if the gross was 12X, then the net could be let's say 8X to 9X to 10X somewhere in there, depending on your REIT deal. If you were selling the real estate for a 6% cap, it was much different than where it got to 8% or 9% caps, where it also made it challenging to use that strategy of flipping the real estate.

Client 00:14:03

I've got this backwards, but wouldn't the net multiple be higher because the earnings would be lower because you're taking out rent? Maybe I have it backward.

Expert 00:14:13

That's right. If you had, let's say you had $1 million in pre-rent EBITDA and went to $700,000 because your rent was $300,000, then your net would be higher.

Client 00:14:25

I think we're on the same page. No problem. Do most people when they're talking multiples, are they usually talking gross multiples or net multiples?

Expert 00:14:33

We would talk in gross multiples. Hold on. You would have, let's see, I'll pull one of my spreadsheets, if I had one handy, but think that through. It's been a while since I worked through one of those valuations. Let me think about that.

Client 00:14:47

If you don't know the answer, that's fine. It's not super important. For most transactions you looked at, did they include real estate or not?

Expert 00:14:55

Most of the transactions included the real estate. The real estate, again, often would not be lease in place between an affiliate real estate LLC that the owner had with his operating LLC. Often they were just living there for free in the real estate that was owned on the balance sheet of the business, but they weren't charging themselves rent.

They would often be selling the real estate with the site. Sometimes the owner would keep the real estate and we would be okay with that. Just charge us rent now and then we would offset the valuation by the rent that you would be charging us. Sometimes owner would want to keep the real estate entity, be a landlord to us, and then have that mailbox money coming in every month through the rent. Oftentimes they would be selling the real estate as well, and then we would get the revolt.

If we had a REIT involved, the real estate, typically the REITs wouldn't want to go too much higher than $5 million-$5.5 million of real estate value that they would be paying for the site. There was this cap on how much we could have the REIT participate in the total purchase price. Let's say we were buying an operator for $10 million and they had just one site. Let's just say it's a simple one site, $10-million deal, the REIT we could have sign up for $4 million-$5 million of that and then we got to come out of pocket for the balance to make the purchase price payment to the seller. The REIT would be funding 40%-50% of that deal in that example.

The trade-off is we're selling that EBITDA. We're selling that EBITDA for whatever the inverse of the cap rate was. It made sense when the cap rates were 6%, because now you're selling that EBITDA for 16X-17X. If that's what we thought, ultimately we would be worth it, an exit, then it made sense to sell that EBITDA at that cap rate. Once cap rates again got bid up with everything else in 2022, now we're having to pay 8X-9X. 12X-11X on that EBITDA maybe then didn't make sense. That's where we got stuck trying to make work.

Client 00:17:00

Hold on. Walk me through that. The way you would kind of think about that was you would apply the cap rate to the EBITDA or is it the rent expense?

Expert 00:17:09

It was doing both. Let's say it was we're going to sell the real estate for $4 million at a 6% cap rate. The rent became $240,000 and we would have to just check that against the P&L and make sure that site could afford that much in rent. Also, for the purchase price capital and funding, the REIT would be funding $4 million in that simultaneous transaction. That $4 million is coming into us and we're in the same breath paying the seller $10 million, so now we just have to come up with $6 million. $4 million is coming from the REIT. It was just a financing strategy. We're giving up $240,000 in EBITDA out of that site by now paying that in rent to the REIT.

It may have been zero again if the seller wasn't charging himself rent. That's $240,000 incremental to the P&L. Maybe he was paying himself some sweetheart deal of over $100,000 a year from his affiliate, so now the incremental is $140,000. We would just have to evaluate it both from a P&L impact as well as what it did for the funding. The check was we're selling that EBITDA, the $240,000 in EBITDA, and so the inverse of the cap rate made sense, that that's the proxy for the multiple that we're selling that EBITDA at, 1/6, 16.7X to sell that EBITDA made sense when we thought we were worth that.

Client 00:18:34

This is making sense. Let's say the inverse you have 16.7X. Walk me through that. What is the dynamic there between that and then what you think your company is worth? How do you think about those two?

Expert 00:18:46

We had private stock. We would quarterly update what we thought the value of our stock was for all of our shareholders internally, just as an exercise. We weren't selling anything, but just to know how it was trending. We would peg our valuation against Mister and what it was trading at. We would also look at private deals of larger scale operators that were transacting around that time and just trying to get any intel around what those multiples were. We would try to figure out what a reasonable multiple would be for us at an eventual exit.

We would typically land somewhere between 15X and 18X for our company valuation when we would do that exercise with PwC quarterly. As long as that internal valuation multiple was lower than or at least equal to the inverse of the cap rate, then selling the EBITDA on a deal made sense. Also, obviously we were trying to pay attention to that for the arbitrage on what we're paying for a smaller operator and making sure we had a good spread on the arbitrage of the multiple we're paying the seller versus what we thought ultimately we would sell for. A lot of different dynamics there, if you can follow me.

Client 00:19:58

Walk me through this example again. This one site location. Say it's just doing $1 million of EBITDA and let's say we're acquiring it for a 10X gross multiple, so $10 million purchase price. Let's assume we're getting $4 million from the REIT at a 6% cap rate. Using the math, we're getting to a $240,000 rent expense, which brings down the EBITDA to $760,000. The purchase price goes from $10 million to $6 million and then so your implied multiple is 7.89X.

Expert 00:20:31

That's where the net came down because the $4 million would be offset against what our net. That's how it goes the other way with the net being lower.

Client 00:20:40

You got to take out the purchase price.

Expert 00:20:42

Yeah. You take out the REIT proceeds from your internal calculation of your what you're paying actually on the net purchase price.

Client 00:20:50

It comes down if the inverse of the cap rate is higher than the gross multiple.

Expert 00:20:55

That's right. We wouldn't do the REIT. We would just hang on to the EBITDA. We didn't like that as a strategy because we didn't want to be a holder of real estate. In those cases we would just have to either walk away or try to renegotiate with the seller, which is why a lot of those deals after 2022 didn't even make sense to try to make them work because the cap rates were so upside down or we would have to pay such a low multiple to the seller. The seller wasn't interested.

Client 00:21:24

Okay. That's pretty compelling because when I'm hearing 10X for a one-site location, that sounds high to me. The actual, in actuality, they're only paying 7X or 8X, and so it reads more attractive. That's how people pay 15X or talk themselves into paying 15X if they were getting, I don't know, like 4% cap rates or something.

Expert 00:21:46

Right. You pick up some COGS synergies. On chemicals and supplies for the car washes, you get much better cost per car through your chemical suppliers than the single-sign operator. There is some operating synergies that help with that headline multiple.

Client 00:22:01

How much can you quantify that for me, even just directionally? I don't know, you can buy at a 10% margin, but the post synergy margin is 12%. Any kind of directional guidance you can provide there?

Expert 00:22:13

We used to talk about it in the cents per car that the variable cost was. It would be, let's say a small operator, would be paying $0.50-$0.60 a car. We come in there and we're going to pay, it's going to get down to $0.35-$0.40 cents a car.

Client 00:22:29

Is that just for chemicals or is that all-in cost?

Expert 00:22:33

That's just the chemical soaps and chemicals, which is the main part of your COGS.

Client 00:22:38

What percent of COGS is it?

Expert 00:22:39

Probably 80%.

Client 00:22:41

That's meaningful. All right. Really helpful. Starting to understand this more. Maybe talk me through cap rates too. Where were they today?

Expert 00:22:49

Back when I started, we were really institutional REITs. We didn't try to go to the private market and the 1031 market through brokers or other avenues that were available out there. Our concern was always the timing and certainty of close, which was critical that it all happened at the same time so that we had that offset immediately. We stuck with larger REITs. We worked with Realty Income and then we worked with what was the other one up in New York. They'll come to me. Anyway, reliable REITs had the money, were interested in the space, formed a good partnership with them.

They were always there for us when schedules shifted and stuff like that. They had the flexibility to move with us as the deal was changing dates and all that kind of stuff. We were paying a little bit higher than market just for that certainty. Let's say our cap rate was typically 6.25%-6.50% back then and even through 2021. Some people were able to get 5s percent, 5.5% by going to the private market. That would require a Mister, they would buy, they would do the transactions and they would later package and say 20 sites in a geography and then put those out to market and shop it for buyers.

They could get maybe whatever 100 basis points better on their cap rate by doing that. Our strategy was different and we were trying to stretch capital and we wanted that offset immediately. Anyway, we were starting to climb in 2022 to high single digits. That's where it just became unworkable as a financing strategy for us to be able to do M&A. By the way, we also would do it on greenfield locations. We were building a greenfield and when it would open we typically had a third-party developer that was developing the site turnkey for us, and so we're paying the developer at closing or handover of the site.

At that point in time we also would have REIT lined up to buy the real estate portion of it. That rise in cap rates also impacted our ability to get greenfields done because now we had to factor in a higher cost for the rent and the cap rate to the total cost of that project. Those became harder and harder to find sites that would work because of that.

Client 00:25:04

Interesting. Where do you think they are today?

Expert 00:25:06

I'm sure they're falling now. I would guess they're probably back in the high 7s percent, 8s percent, somewhere in there. They trend pretty close to what's going on with interest rates in general out there. Follow that correlation.

Client 00:25:20

What about just overall REIT sentiment? Are there a lot of REITs out there still interested in car washes or is there desire to own car washes pulled back as well? Some of the broader sentiment is maybe pulled back.

Expert 00:25:32

Most of them would try to have any particular industry vertical represent no more than 10% of their overall portfolio, and so they always were of keeping an eye on that. Neither of the REITs that we worked with were nearing that threshold. I'm sure there's still appetite for it out there and just the two that we work with, there's others that were also in the space, unfortunately, a couple of them were acquired by Realty Income and so they became part of Realty. Spirit was one and Vereit was another. Anyway, I'm sure there's still people that are interested in the space.

Here's the problem with this whole strategy. As you fast forward to, let's say, peer-to-peer consolidation.

This is something I always would bring up with our board and our CEO and none of them really seemed that interested in it. We've got such a specific used property like a car wash that can't be repurposed. Now let's say GO buys a company, let's say Clubvoucher, which had a lot of locations in Kansas City. Now, what are we going to do when we try to consolidate real estate? Let's say we've got a site across the street from one another and now we're the same company, do we really still want both of those sites? If we don't, how do we get rid of one?

We got a 20-year lease that's very punitive to get out of with Realty Income and probably did the same thing and they've got a lease. Now what? You can't really go to the REIT and say, "Well, hey, just find another tenant because no other car wash operators is going to want to come in there and that's the natural other tenant." Who's going to take that site and scrape it and rebuild it as a Chick-fil-A? It's going to be expensive for them to step into that lease on the real estate and do something else with the building that can't easily be repurposed.

As peer-to-peer consolidation, which needs to happen once that starts playing out, there's going to be a lot of problems with getting rid of real estate. If you want to truly consolidate and take some capacity out of the market, which needs to happen in certain markets it's the looming problem.

Client 00:27:39

You're saying it'll be an issue if there's peer-to-peer consolidation and you have overlapping or competing sites and you just need to close them?

Expert 00:27:48

Yeah, what are you going to do? You can't easily do that. A lot of markets got overbuilt because all this race to capturing share and some operator strategy was to find a successful site and build across the street literally from it and just take half of the pie because it's a proven corner where people are getting car washes, so I'll just take 1/2 of what they have. As long as my build economics makes sense, I'll just do that. I don't have to worry about the market research and figuring out where to go.

Client 00:28:19

Maybe let's talk about that too, just what you see as the outlook for this industry. Is it oversaturated? Are there too many car washes out there at this point? Or do you still think it's a good industry? Would you invest your money or do you have concerns?

Expert 00:28:34

Yeah. I still think it's a good industry. The competitive intensity is really market by market. You have to look market by market and figure out if it's overbuilt or not. Markets like Dallas, Houston, Kansas City, Phoenix, some of these early markets that people rushed into are oversaturated. I don't know if you've driven around any of these car wash crazy markets, but there's literally car washes. There'll be four on the same street. It's gotten insane. There's certain markets where it's going to be a problem around consolidation. You can pick the right dance partner.

If GO were to try to sell or buy a peer, just make sure it's a peer that has limited overlapping geographies and is more complementary from a geographic standpoint, and then that makes sense. I think there can be some mergers and consolidations that occur at that peer level, but you just have to be careful with your dance partner and try to make sure it makes sense. In general, I think the outlook is good. I still think people want to get their car clean. There's just a lot of capacity out there that needs to be taken out. I don't know how you do that, but some of these markets are just oversaturated. Maybe just have losers and just take the loss. There's still a lot of white space.

Client 00:29:48

Has de novo or greenfield activity slowed? Are people still building a ton?

Expert 00:29:52

It certainly has slowed from those crazy years, but people are still finding locations to build sites. There's still stuff going up. I see it around here in Denver, where I live, there's new locations coming soon in different pockets. A lot of people are looking out of the urban centers right into suburban areas where the growth is happening with rooftops and retail hubs, growth grocery stores and stuff like that. You have to pick your spots better and anticipate population growth and where things are happening and tracking where home builders are planning the next suburban location. It just takes a little bit more effort to find those pockets.

There's still those pockets out there, even in these saturated markets. There's other markets like the Northeast, where it's still predominantly what we would call the older model car washes, where it's a full serve or the customer has to get out of their car and they're sitting around in some dingy customer waiting room for 20 minutes while somebody's driving their car through the tunnel and cleaning the interiorr it's in bay automatics, which don't clean as well and aren't as fancy as we express. There's still a lot of conversion of the market that can occur in the Northeast with converting to the express model that has been all the rage in other markets.

Expert 00:31:11

There's still areas in the Midwest that are not saturated, Pacific Northwest. We would say this is probably a year or 18 months stay on that but there was 9,000 units in the market. Our study showed that you could double the number of units in the U.S. market so you could get to 18,000 and where it would still make sense for those additional 9,000 units being planted somewhere that you could hit your average unit economics. It's still, I think, a promising market, but now it has a lot of challenges from the past and the crazy heyday of overbuilding in some markets.

Client 00:31:48

Okay. Do you think valuations are going to come down over the next year or two or do you think they're going to head back up or stay where they are?

Expert 00:31:57
Depends on how many peer-to-peer consolidations happen to try to take some capacity out.

Client 00:32:02
Someone mentioned this and I don't know if it's true. I don't think it is true. I think he was exaggerating, but he told me 19/20 largest players are insolvent and really struggling. Would you agree with that, or is there industry-wide struggles going on to that magnitude or do you think the industry is doing better?

Expert 00:32:22
Wouldn't declare them insolvent? Certainly we were pinching pennies and looking for ways to cut costs and pulling back on new investment just because we were tapped out on debt borrowing because our debt borrowing was EBITDA-based and when EBITDA is flat, you can't really borrow anymore. It didn't make us insolvent. We still were generating cash from operations to keep chugging along. Some operators I think got overextended. There's a few that were paying some of those crazy multiples because they were trying to emerge during the frothy time of the market.

Some of those guys got overextended and maybe they have more problems with their balance sheet. I would say most operators were smart enough to pull back and weather the storm. I don't think 19/20 are insolvent for sure. That's maybe three to five are. You would have seen a lot of bankruptcies popping up already. People going out of business.

Client 00:33:18
You have or haven't?

Expert 00:33:20
I said you would have seen that if this guy's theory was correct because the tough part of the market was 18 months ago, it's not today.

Client 00:33:28
Okay. Got an unrelated question for you. Another area we've been looking at is facility exterior services and looks like you might have some experience there. I'm not looking for anything insider, but what do you think about the dynamics there? Is that an interesting market to you or any concerns?

Expert 00:33:47
Yeah. That's why I was enticed to jump from GO, which we obviously weren't doing a lot of strategic growth at the time. It's very fragmented space. There's a lot of different service categories within that. Everything from exterior maintenance, window cleaning, pressure washing to minor repair work, to full scale facade replacement, to waterproofing, repair and restoration, to all kinds of concrete repair. There's a lot of different categories. Roofing, which is an area we're

looking at, which we get a lot of requests from property managers that have issues with the roof as well, facade, and, "Why can't you just do both for us?"

There's a lot of service areas that fall within that broad sector, and there's a lot of small players. We're probably the largest in that space. We are the largest privately held in that space. We're about 500 million. The drop off from us to the next biggest player, probably next biggest player is maybe 100 million. There's a lot of 10 million to 20 million to 50 million players out there.

Client 00:34:49

One of the things we're worried about or have questions about is it's super fragmented, but is it too fragmented? Are we able to find a platform for us? It would be like $2 million or $3 million in EBITDA and then looking to do add-ons that are $1 million- $3 million of EBITDA. Do you think there's opportunities out there or do you have to be comfortable acquiring $500,000 EBITDA companies?

Expert 00:35:15

Competitively? I'll tell you, stay away now, we don't want you messing up our space. There's players out there that are, there's one in market right now that's $50 million in sales and they're saying adjusted EBITDA is six. It's a profitable business if you could do it right. You can get gross margins north of 40% and new net margins 15%-20% or EBITDA margins. There's a mix of union and non-union depending on what trade you go into and which markets you go into, but.

Client 00:35:44

Are you able to cross-sell the services or not?

Expert 00:35:47

Yeah, especially with property managers that want the least number of phone calls they have to make as possible. If you have crews that can do multiple trades and do all of the fair work that's needed from a scope that they're getting from an engineer that's evaluating building or whatever, then you can capture a lot more of that work with the more services you offer. Now you need people who know what they're doing obviously to be able to say you can do all that work, but there's a lot of wallet share as you guys say, to capture.

Client 00:36:20

That's good to hear. I think that's one thing when we looked at other industries, people always talk about cross-sell but once you actually get into the industry and you're acquiring companies in different segments, executing on that cross-sell can be harder than initially thought. It sounds like you guys have been able to successfully do that.

Expert 00:36:41

Our secret sauce has been how we've been able to grow so big. We started as a window cleaning business, Valcourt. The legacy was in D.C. as a high-rise window cleaning business. Their crews would be on the building and this dynamic would happen. The project manager would come down and say, "Hey, you got some seals that are cracked. Looks like you got water intrusion. You got some other stuff going on with the windows." They would go away. The private manager would say, "Well, why can't you guys just do that for me?"

They started getting into this minor repair work where they're just resealing windows, caulking, doing some minor waterproofing repair. That exploded into full-scale facade repair over time by just getting those questions again of, "Hey, we've got some bricks that are failing here on this corner of the building. Can you guys do that?" We got the masonry. It can mushroom in a good way on you like that to where the property manager knows you, trusts you, and now you're doing multiple services for that building.

Client 00:37:43

Last question. You're keeping in mind that you're trying to find a platform, any segments, where you think there's more sizable opportunity to plant your flag or would be a good place to start?

Expert 00:37:55

Geographically or within service lines?

Client 00:37:58

No, service lines, like which segment service lines.

Expert 00:38:01

It's where we live. Waterproofing, masonry, concrete repair and roofing. There's a big push, not push but a lot of interest between waterproofing, facade restoration companies getting into roofing and vice versa roofing, commercial contractors looking at the facade because again, all of our customers are asking us do it all for them. There's a lot going on between roofing and waterproofing, building envelope contractors right now. Those are the two hot spaces.

Client 00:38:29

That's really interesting. Not to get too off topic here, but I appreciate that. That company sounds like you guys are doing terrifically well, so it sounds like a good one to join.

Expert 00:38:40

One of the cautions within that space is you see folks that get pulled into things like landscaping. There are some players that are doing landscaping, what else, snow removal, stuff like that. We have highly trained labor and techs that we hire that aren't afraid of going up on buildings to clean the windows or to repair something on the building.

It's just more skilled labor that's required is the way we think about it, than doing those less skilled labor services for the building. Some folks have been tempted into that or asphalt repair in the parking lot and stuff like that. You'll see some players that delve into that as services, but that stuff is lower margin and less skilled labor than sticking to the higher skilled services like we've done.

Client 00:39:25

You're focusing on sticking to more vertical services.

Expert 00:39:28

Yeah. We say our competitive advantage is working at height. Anything that we can do at height that requires intricate rigging of platforms for workers to stand on to do that work and the technical expertise to figure out how to go about replacing entire masonry facade of historic building or things that require a lot more brain power than just replacing the shrubs around the base of the building.

Client 00:39:54

I really enjoyed this. Thanks for your time.