Impact Investing Newsletter
December 2021

From Disposal to Renewables: ESG Investing in Yard Waste Recycling

By Sasha Grutman, David Tanzer, and Matt Rossi

In a society that is grappling with environmental challenges, social tensions, and questions of inequality, it is no surprise that ESG investing ("Environmental, Social, and Governance") has become a topic of immense interest. ESG investing deploys capital in companies that address these issues while generating acceptable returns for the capital providers that fund them.

Windrow turner producing compost from yard waste

Many institutional investors seeking ESG exposure have accepted lower returns from their ESG investments, but merchant bank Middlemarch Partners takes a different approach toward ESG. It seeks to "do well economically" as a precursor to "do good for the environment and society at large."

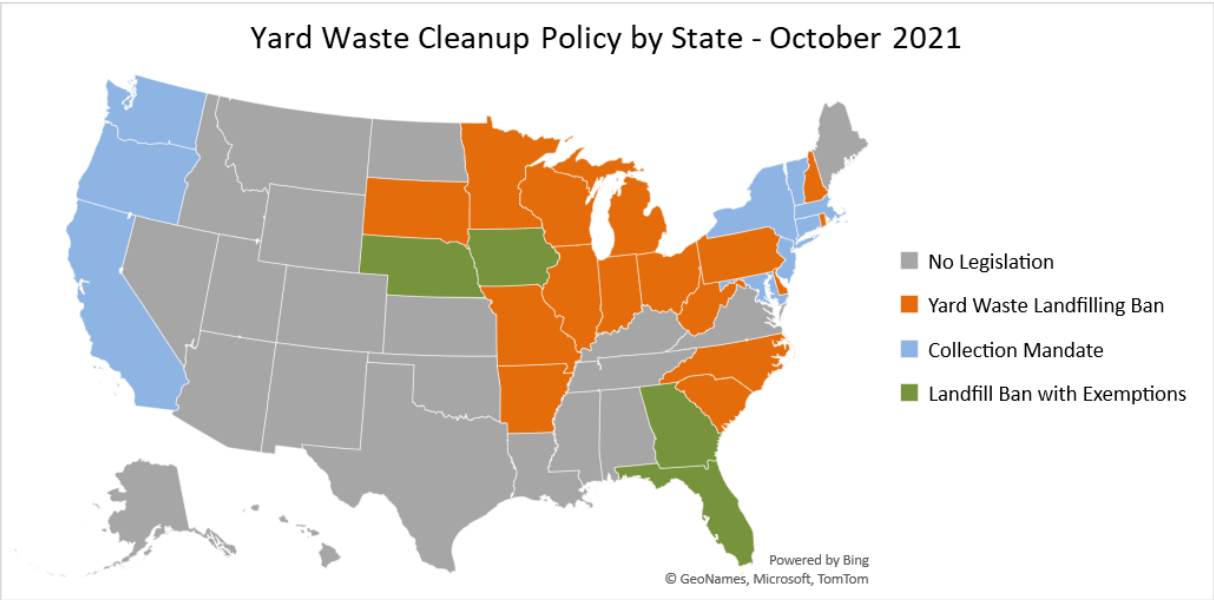
Contrary to the conventional thinking that assumes ESG companies cannot generate high investor returns because environmentalism is a drag on profits, Middlemarch believes its growth-stage ESG merchant banking clients need to generate 25-50% IRRs for the private equity firms that invest in them. Middlemarch believes the best way to advance ESG goals is to focus on businesses that can deliver strong returns with no "greenium" return discount for achieving environmental or social goals. As investors prove that one can make money and improve society at the same time, it will help build momentum for ESG investing.

Middlemarch recently served as the exclusive investment banking advisor to help create Veransa, a company which takes leaves and grasses and converts them into high-quality, organic compost and transforms tree waste into bio-fuel wood pellets. Middlemarch partnered with the management team that conceived of the idea of a yard waste recycling company, sourced the lead investor, and co-invested in the company. Veransa' compost is sold to farmers and consumers so they can replace chemical fertilizers with an organic product that enriches their soil. And the wood pellets are sold to energy production companies which use the pellets as an alternative fuel source to coal.

Middlemarch believes Veransa can capture superior economics, generate 30%+ annualized rates of return for its investors, and at the same time improve the environment, support organic farming, and sequester carbon from the atmosphere.

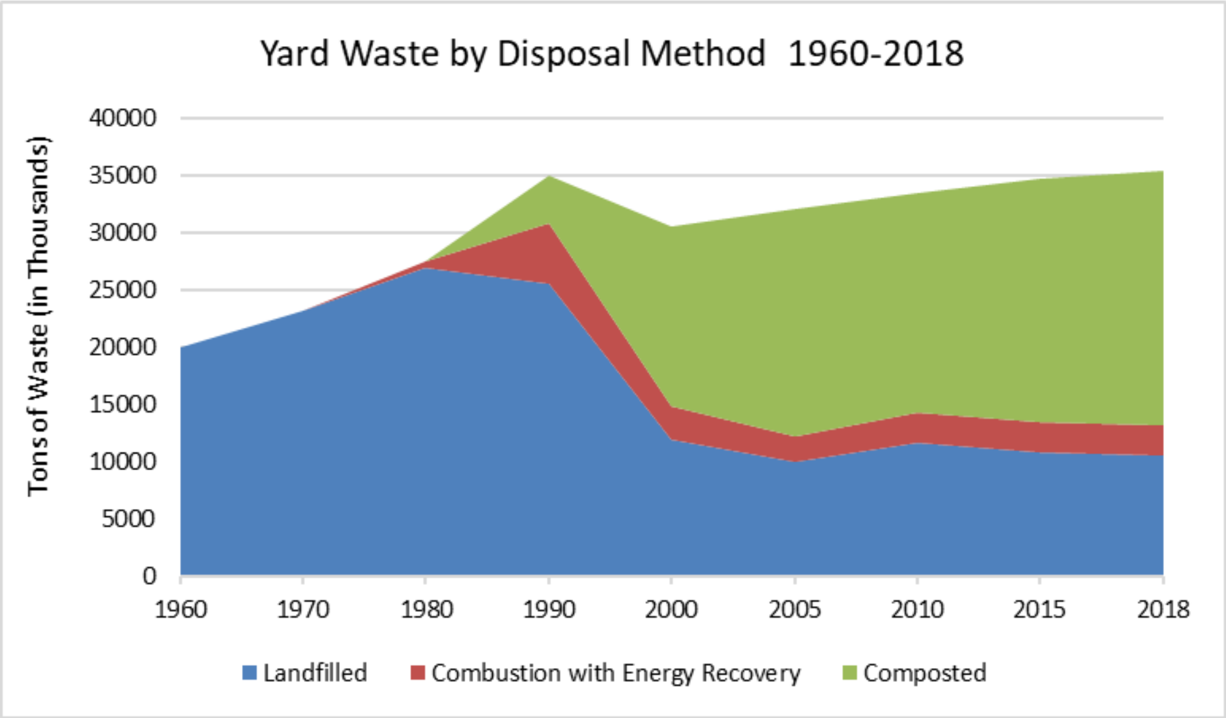
How the Yard Waste Industry Operates Today

The Yard Waste Industry is highly fragmented and is shaped largely by state-level regulations that define how yard waste must be handled. Currently, 20 states enforce mandatory disposal of yard waste at dedicated collections disposal sites, and an additional 9 states require yard waste recycling, meaning that the waste cannot be landfilled.



Source: US Composting Council

Most yard waste operators are "mom and pop" small businesses that lack the capital to make major investments in highly efficient waste processing equipment. Yard waste collections businesses have historically provided yard waste intake (at company-owned collection centers) for municipal and commercial clients. They generally perform this service for a "tipping fee". These clients are generally landscapers, yard maintenance companies, and tree maintenance companies. After separating clean wood waste for sale to decorative mulch companies, they have ground up the yard waste and transported that minimally-processed feedstock to local farms – at the expense of the collections company – or sold that "green waste" at low prices to companies for further processing. In many states, 90 percent of yard waste feedstock goes to local farms and ranches for use as low-value, rudimentary topsoil that decomposes naturally over 18 to 24 months.



Source: 2018 US EPA Research

Vertical Integration and Upgrading Compost Processing Technology Transform the Industry

Middlemarch and its client Veransa identified a significant market inefficiency in the yard waste collections market that could be exploited for economic advantage. By combining the collections business with a compost manufacturing business, an integrated yard waste company could earn more revenue, lower its overall operating costs because the two businesses leveraged each other's capabilities, and transform a waste disposal business into a recycling business.

The opportunity for vertical integration and composting technology investment supports the vision for a higher volume "professional yard waste company." To create it, Veransa is spending millions of Dollars upgrading its yard waste processing and compost manufacturing infrastructure, with a focus on electrification to reduce costs and generate a superior environmental profile. The consequence of this investment is a business with significant cost synergies and two revenue streams from yard waste collections and compost sales. The environmental impact of this combined business model is also markedly improved, as farmers can immediately lay down organic compost to improve soil remediation, to enable carbon sequestration, and to decrease (or eliminate) chemical fertilizer use.

These environmental benefits are especially important in states like Florida, where coarse soil contains large amounts of sand and clay, contributing to decreased moisture retention and nitrogen fertilizer runoff. With sandy soil in need of remediation, positive regulatory pressures on yard waste collections, and economic incentives in higher margins for farmers that grow organic crops, Florida is one example of a geography where a combined "waste-to-compost" business is built to succeed.

Veransa Transaction – Two Acquisitions That Can Transform an Industry

Middlemarch Partners acted on the fragmentation in the yard waste market by advising two waste-to-energy and compost industry executives, Marc Owensby and Roger Johansson, and private equity firm RFE Investment Partners on their acquisition of the collections business and the compost manufacturer in a transaction that closed in July 2021. The combined entity became Veransa.

The Veransa transaction transforms the waste disposal industry into a recycling industry and highlights Middlemarch's ESG investment principle of finding businesses with both clear economic and societal benefits. Middlemarch believes it is critical to address ESG objectives and generate strong returns for the private equity firms investing in Middlemarch's clients.

Since the closing of the Veransa transaction, the Florida waste market has responded positively to the introduction of Veransa as a professional yard waste company. With the fastest-growing population and the fastest-growing agricultural market in the United States, as well as with its low organic farming penetration, Florida is uniquely in need of the innovative solution Veransa is providing. Veransa gives farmers a viable organic compost solution at low cost and increases organic growing capacity in the state. It also supplies organic compost to bagging companies addressing the fast growing bagged organic garden compost and soils sector.

Veransa's compost end-product will have a significant positive ecological impact in replacing chemical nitrogen-based fertilizers, increasing organic farming (for which economic incentives already exist), and enabling greater carbon capture. In Florida, with sand-based soil recently reported by Palm Beach Daily News as increasingly "a debilitated soil with compromised structure unable to withstand drought … and unable to store carbon", Veransa's positive environmental impact is particularly valued.

Green waste transformation allows for organic farming

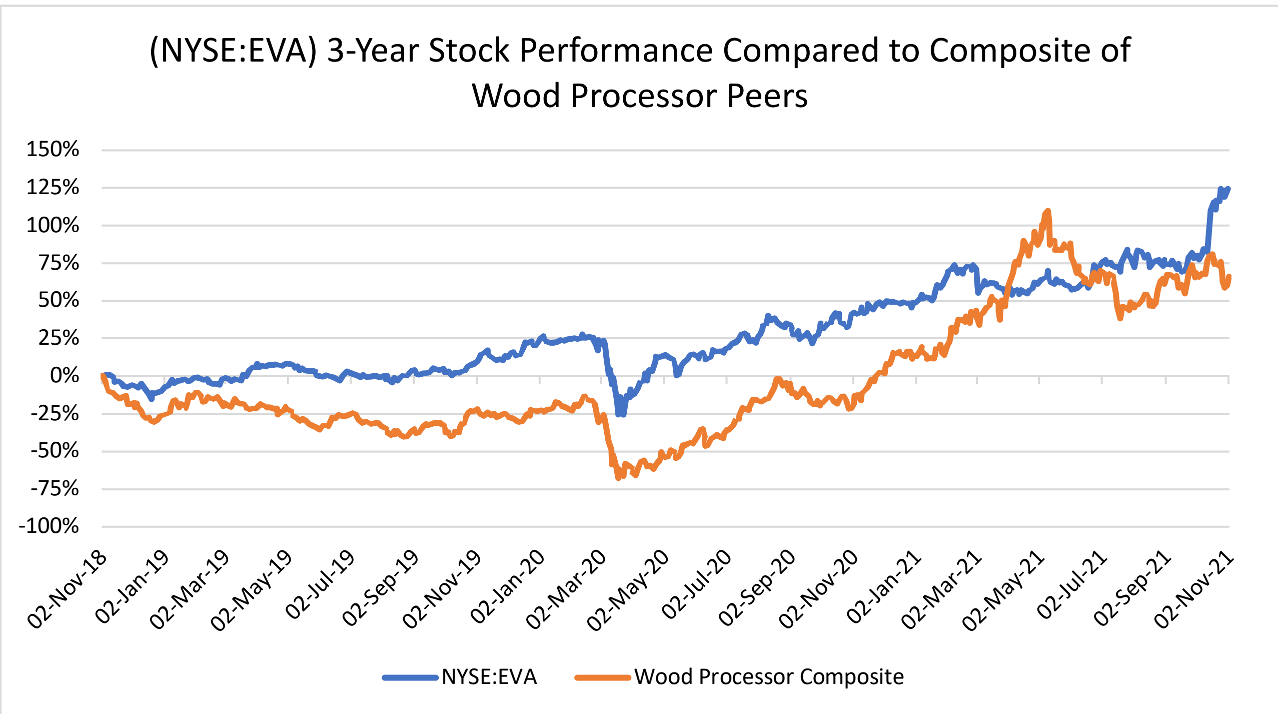
Public Companies in the Yard Waste Sector Pursue Other ESG Angles

Veransa is focused on addressing the unmet need for organic compost by processing yard waste in an innovative way. Two public companies are using yard and wood waste to address the need for alternatives to coal as an energy source.

Enviva Partners (NYS:EVA), the largest global producer of wood pellets that are used as an alternative biofuel to coal and natural gas energy, has grown rapidly as energy producers have sought cleaner feedstock sources. Enviva sources wood from commercial and private landowners and often uses wood fiber left over from the logging process with no other market value as material inputs. The majority of

Enviva's sourced wood – known as "wood residues" – consist of treetops, branches, and sawdust left over from logging. While the logging process itself is not carbon neutral, Enviva buys only from landowners who agree to regrow trees cut down by logging. These landowners have an economic incentive to grow greater numbers of trees which capture carbon, offsetting carbon emissions from power plants where Enviva's wood pellets are burned as fuel. Enviva converts the wood residue into pellets across its ten US plants and exports these wood pellets to the company's primary end markets of Europe and Asia, where many municipal coal power plants have been redesigned to burn wood pellets.

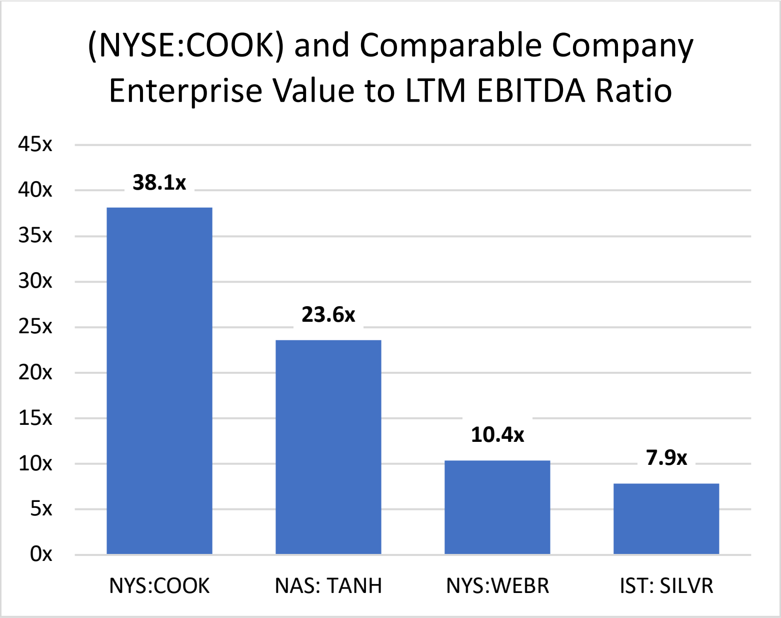
In response to heightened demand for coal alternatives, Enviva has expanded plant construction and B2B contract growth, propelling Enviva's stock price more than 50% this year. Compared to competing publicly traded wood processing companies, Enviva has seen significantly higher revenue growth over the past three years and has focused more heavily on plant and equipment investment to scale growth, positively impacting the company's stock. The company has also experienced significant multiple expansion relative to comparable companies over the past year. Enviva shares have increased by 30% annually on average over the past five years.



Source: PitchBook Data, Inc.

For investors interested in newly-public growth companies, Traeger Pellet Grills (NYS:COOK), which completed its IPO in July 2021, manufactures and sells wood pellet grills and is the market leader in the sustainable grill manufacturing industry, holding a three percent market share in the overall US grill manufacturing industry according to recent Piper Sandler research. Traeger also sells wood pellets that are used by consumers in wood pellet-fueled barbeque grills as a substitute for charcoal briquets. While wood pellet grills make up more than 70% of Traeger's 2020 revenue, wood pellet sales also contributed

22% to revenue last year. Traeger has been sourcing hardwood for the production of wood-fired pellets primarily in Europe, but it hopes to expand future wood sourcing into North America as well. Traeger currently trades at a 200% premium on an EV/EBITDA basis compared to other comparable publicly traded grill manufacturers.



Source: PitchBook Data, Inc.

Takeaways about ESG Opportunities in Yard Waste Recycling

Middlemarch has identified a number of insights from its experience facilitating a private market buyout in an ESG sector and from its review of the public investment opportunities in yard waste-related ESG companies.

Many ESG-focused investment firms are recently formed and are only beginning to accelerate their investment pace. Middlemarch identified 29 large ESG-focused private equity funds active over the last fifteen years, with an average fund size of $979 Million. Of this fund group, more than half finished raising capital in 2018 or later. Additionally, of those recently closed funds, the majority have only started investing within the last twelve to eighteen months. It appears that investment pace is only beginning to pick up and investors are being quite selective about what ESG projects they will finance.

Most ESG businesses are complicated and require detailed understanding of regulation, technology, and evolving market demand. Yard waste recycling is not fundamentally a complicated business, but it involves state regulations about how yard waste is handled, awareness of environmental impacts from processing yard waste, an understanding of logistics and capital equipment financing and management, and an appreciation of the marketing associated with helping farmers and consumers to embrace organic compost as a substitute for chemical fertilizer. RFE Investment Partners had in its last fund two very successful exits in waste management and in garden products companies. This enabled RFE to quickly grasp the opportunity in yard waste recycling.

Making ESG investments requires disciplined focus on identifying businesses with strong profit potential. Many investors express interest and curiosity about ESG investing, but businesses with lower returns are a turn off for many economically focused investors. Middlemarch has found that grounding the investment case in above-market returns rather than focusing mostly on the environmental benefits as well as developing a deep understanding of the value drivers of an ESG business made for a more attractive investment candidate for a larger universe of potential investors.

Middlemarch seeks additional ESG opportunities that produce strong economic returns and address environmental and social issues in productive ways. The firm has learned how to marshal both the economic strategy and the ESG story in a way that appeals to investors seeking exposure to ESG investment opportunities. The firm believes that the best thing that can happen for ESG investing is to focus on the businesses that can generate strong returns quickly and demonstrate that ESG can help investors achieve their economic objectives. This will encourage private equity firms, limited partners, and asset managers to have greater conviction that supporting ESG investment strategies has sound economic logic as well makes sense from a social good perspective. Ultimately, Middlemarch believes that expanding the universe of investors able to make ESG investments and providing ESG entrepreneurs the growth capital to support innovation and to create high returns businesses are the best ways to create a truly virtuous cycle that results in sustainable environmental impact.

Contact Information

Sasha Grutman, Partner

Middlemarch Partners

sgrutman@middlemarchllc.com

212-913-9660 x1