TRC COMPANIES CONTINUES TO BUY IN PURSUIT OF “PROFITABLE GROWTH STRATEGY”

Following a period of re-structuring in the mid- to late 2000s, venerable environmental consulting and engineering (C&E) firm TRC Companies, Inc. (Lowell, MA) embarked upon a growth strategy that includes acquisition as a key part. Acquisition was nothing new to the company—it had engaged in many deals over the years leading up to the restructing period—but this time around, the approach would be different, with greater discipline, sharper focus on the bottom line, and full integration from day one.

“Since we came out of the restructuring effort, we’ve turned our focus to a profitable growth strategy, and we felt acquisition had to be a part of that,” says James Stephenson, TRC’s senior vice president of corporate planning and development. Organic growth is a key part of the strategy, but “you can only grow so much organically in a people business, so three years ago, we embarked on an acquisition strategy that supports our overall goal of growing net revenue over 10% per year.”

Stephenson, one of whose responsibilities is overseeing TRC’s acquisition campaign, emphasizes the “profitable” in profitable growth. “We’re not chasing revenue,” he tells EBJ. In the eight deals completed since February 2011, the company has been successful because “we’ve been very disciplined, have not overpaid, and have not chased revenue for revenue’s sake. The deal has to add to the bottom line.”

It wasn’t always so for TRC, Stephenson acknowledges. Recalling the C&E sector’s days of rampant consolidation in the 1990s and 2000s, he says “you can put TRC’s name next to those other firms” that acquired to get bigger, and that allowed a certain autonomy for the acquired entity. “We unwound some of those deals and turned 180 degrees,” he notes, emphasizing the company’s new discipline in evaluating potential acquisitions, negotiating the deal, and then embarking on a “90-day plan” to fully integrate the acquired entity into TRC.

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Growth has followed. For the quarter ending on March 29, 2013 (the third quarter of the 2013 fiscal year), TRC, which now employs about 2,900 people, reported net service revenue of $83.0 million, up about 11% year over year. The company divides its net revenue into three business sectors: environmental, representing about 51% of net service revenue; energy, accounting for about 36%; and infrastructure, accounting for the rest.

The acquisition campaign has continued into 2013 with four deals completed through July. Like the deals before them, these four additions have been primarily aimed at strengthening the business in the environment and energy sector, with the latter representing TRC’s fastest growing business segment.

“We’re leveraging the synergies between the environmental and energy sectors, supporting utilities, power generation, oil and gas, real estate developers, and our other clients, and trying to support the growth of those sectors by expanding what we already do in a new geography or by adding some technical strength,” says Stephenson. “In infrastructure, we’ll make some key hires, but I don’t think we’ll see a big acquisition in the near term.”

In January, TRC completed the acquisition of Heschong Mahone Group, Inc. (HMG; Gold River, CA), a 40-employee provider of building science, policy development, and program management services in the energy efficiency marketplace. “We do a lot of power delivery engineering, but we also have this faster growing practice in energy efficiency,” says Stephenson.

What the addition of HMG achieves is adding strength to the program management skills that TRC can deliver to utilities and to state funded entities like the Long Island Power Authority (LIPA) and the New York State Energy Research and Development Authority (NYSERDA). For these entities, TRC designs and implements programs for reducing energy consumption in, for example, multi-family buildings, and “HMG was doing the same thing in California” for the likes of Pacific Gas & Electric (PG&E), according to Stephenson. Under Proposition 39, California has earmarked about $500 million per year over the next seven years for energy efficiency improvements, so the addition of HMG means a strong presence for TRC in a lucrative market, he adds.

TRC followed quickly with the acquisition of the air emissions testing business of GE Power & Water, strengthening a practice that had been a foundational business for TRC and remained a core capability. The GE entity had been number two in the stack testing business behind TRC, says Stephenson, and its addition brought on board 55 people in five offices in geographies that TRC was not serving, as well as a master service agreement with General Electric Co.

In May, TRC acquired the Covina, California, office of Ocampo-Esta Corp., a power delivery engineering company.

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that fulfilled a geographic expansion goal. “We can’t do everything from the East Coast,” and “in the power engineering sector, utilities demand very close proximity,” says Stephenson. With the Ocampo-Estrella operation, the firm can now support the likes of Southern California Edison and San Diego Gas & Electric, he adds.

In July, TRC added **Utility Support Systems, Inc.** (USS; Douglasville, GA), an engineering company providing technical services to the power utility markets. USS’s key strength is the provision of distribution engineering and storm support services to power utilities such as ONCOR, Georgia Power, and utility cooperatives. USS employs about 90 people full time but relies on a staff of about 200 on-call people to help utilities respond to hurricanes or Sandy-like storms. The addition of USS doubled TRC’s on-call capability and “really gets us to full-service capability in distributing engineering from Maine to Florida to Texas,” says Stephenson, who identifies power distribution engineering as a major growth area for the company.

Rather than engage in a formal search process through a third party, TRC executes all of its deals in house. It makes initial contact with a potential target through a variety of avenues, from banking relationships to individual employee contact. The HMG contact came through **MorrisseyGoodale**, a Boston-based investment bank focused on the C&E sector, while USS was an opportunity brought to Stephenson by the leader of TRC’s distribution engineering practice.

As for GE, “they reached out to us,” notes Stephenson. “They knew our position in the market. They had tried to sell the business about five years before but the valuation expectation was out of line, so they came back to us.”

In assessing the relative importance of various factors in evaluating the viability of an acquisition target—consistent financial performance, future earnings promise, quality and depth of the management team, and “culture”—no one “is more or less important than any other,” Stephenson reflects. First in line is the candidate’s alignment with fulfilling TRC’s strategic objectives, and then it goes from there.

Culture is certainly very important, he affirms. “After we identify a firm, we start talking to the management team about how they manage, how they go to market, and what their expectations are. We certainly spend a lot of time talking and getting a read on how they will fit in with us. We like nimble, entrepreneurial people who show a willingness to take risks on a project that others might not take on.”

Integration is full—no “XYZ Co., a company of TRC”—and begins as soon as the deal is closed. “We feel that, with our strategy and the way we go to market, they need to be ‘TRC’ from the start,” says Stephenson. “We operate through a project management style of integration—bring the seller’s people into the process, have champions for each of the integration processes we identify, and check on that progress on a weekly basis.”

Part of that integration involves a solid commitment from the seller’s top management team, which “has to be on board for a minimum of three years, to help with the integration and the transition.” In the end, of course, the principals of the seller’s firm are seen as key to the business and a fundamental part of why the company is being acquired, Stephenson stresses.

No less important is consistency of financial performance, which is especially critical in negotiating the valuation, he adds. “Firms that can show financial consistency will command the higher multiples. With firms that try to build a blow-out year in advance of a sale, you have to ask, ‘is it sustainable?’

“We’re not interested in turnarounds, unless we can understand fundamentally where the weakness is coming from,” Stephenson continues. “If they don’t have good clients, or are experiencing lots of turnover—we’re not interested in spending time fixing those issues.” If the weakness derives from market-related issues or “under-performance we can get our arms around,” then it’s a different ballgame, but fundamentally, “we’re not interested in undertaking major restructuring.”

The big challenges in getting to “yes” on a deal haven’t changed over the years,” Stephenson concludes. Agreeing on the right price is still number one. “People dance around it initially, but at the end of the day, those who are selling need to feel that they are getting the value, and we feel we need to get a return on our investment within four years. Getting to ‘yes’ on a multiple that meets both objectives is always a challenge. We spend a lot of time talking about TRC, getting them to understand us as an organization and talking about opportunities their people will have—not being pulled into something where they are just a number, but instead providing them with opportunity to grow and lead.”