

COMPANY STRATEGY

CECO doubles down on water to boost value

This month's purchase of Kemco Systems is CECO's largest water acquisition in ten years. CEO Todd Gleason believes the fundamentals are there to make industrial water the value creation engine of the group.

The acquisition of Kemco Systems by Nasdaq-listed CECO Environmental this month marks a coming-of-age for the company's industrial water division, which CECO boss Todd Gleason has been quietly building since joining the company in 2020.

It is the fifth water business that CECO has acquired in the last 18 months, after paying an average of between 7x and 8x EBITDA to assemble a cohort of industrial water specialists (see table, facing page). With organic growth currently running in the low double digits, the company expects that around 30% of its forecast 2023 revenues of \$525 million will be derived from water end-markets.

When Gleason joined CECO in 2020, the company's water business was restricted to a few legacy fluid handling brands acquired through the purchase of Met-Pro in 2013. Having spent eight years as a senior vice president at Pentair, Gleason soon saw the potential to complement the group's existing air and energy verticals by diversifying into water.

"We started looking at our portfolio in a more strategic way, and we made a concerted effort to double down on where we were strong – which is customer relationships in heavy industry and energy," Gleason explained to GWI. "We wanted to figure out ways to build a leadership position in niche areas within water, and now it's time to start to really maximise the opportunities between these different brands' capabilities and their channels. We're starting to see some real wins there."

The margins in CECO's water business are higher than those in the other divisions, partly thanks to the sale of custom-engineered treatment systems, which currently account for around 60-65% of the industrial water division's revenues. Gleason is keen to ease this balance closer to 50/50 in future by boosting the after-market side of the business, although he ruled

LISTEN TO GLEASON

CECO boss Todd Gleason has assembled a \$150 million-a-year industrial water business from scratch in 18 months. He is not finished yet.



Source: CECO

out offering operations and finance as part of the package.

"We have now strong niche leadership positions and the ability to do engineered systems globally coupled with standard solutions, whether it's in food processing, industrial laundries, marine, offshore oil and gas, or ready-mix cement," he told us. "As we look at future acquisitions and how we're investing organically for more after-market sales, there's a slight skew in the volume of dollars being applied towards repeatable, short-cycle sales. We have a very strong reputation in engineered systems to solve unique problems for customers, but we'd like to have a larger catalogue of standard products such as replacement filters. We'd like to believe that over time, we're going to build a 50/50 revenue mix."

While the addition of Kemco is likely to mean that around two thirds of CECO's water sales are derived from the US, Gleason predicts a significant uptick in demand for water and industrial wastewater treatment systems in the context of the current reshoring trend.

"We believe there is a very profound and real reshoring of industrial production to North America supported by government subsidies such as the CHIPS and Science Act. We think that that's just the early innings of what's going to be a significant industrial investment over the next five to ten years, and we feel well positioned for that," he told GWI.

The potential for international growth is also a significant driver of revenues, particularly after last year's acquisition of South Korean company DS21. Not only did DS21 bring with it the advantage of being an approved equipment vendor for most of the major Korean engineering, procurement and construction (EPC) companies – its manufacturing capacity is currently under-utilised, offering an outsized growth runway.

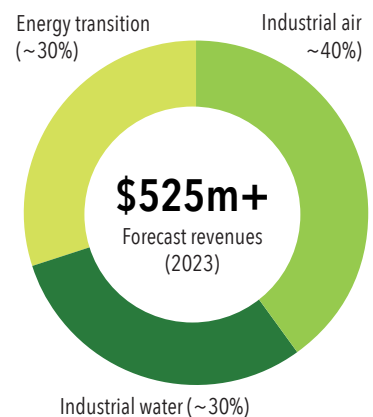
"The combination of our two organisations has unlocked significant growth that has not yet gone through our backlog, which is already at record levels versus where it was a year ago," Gleason ▶

“I believe that water will be one of our largest areas for shareholder value creation over the next year or two.

Todd Gleason, CEO, CECO Environmental

CECO'S REVENUE MIX

The group's fastest growth has come from water over the past two years. It now accounts for 30% of the pie.



Source: CECO Environmental

explained. “We have seen a very nice uptick in cross-selling opportunities across our platforms, and we believe we can smartly leverage our footprint. We feel we’ve got the right infrastructure now to double our sales in industrial water without having to add capacity.”

Given the opportunities for organic and acquisitive expansion, Gleason anticipates that the proportion of CECO’s global revenues derived from water will rise modestly in the near term.

“If water gets to be 35 or 40% of our sales in the next two to three years, I certainly won’t be surprised,” he told us. “We’re going to continue to make investments to have double-digit growth organically and inorganically – we’re programmatic from an M&A perspective, and every one of the deals that we’ve talked about in water has been sourced through our network. We’ve made eight acquisitions in three years, but we’ve walked away from three times as many. I think that speaks to the quality of our awareness of the markets we’re in, and if we can add a business that makes a lot of sense to the future of CECO, then that’s what we’ll do. And if it’s

CECO ENVIRONMENTAL’S RECENT WATER M&A

The Nasdaq-listed company has typically paid 7-8x EBITDA multiples to gain access to a series of custom-engineered industrial water systems suppliers. It has also gained backdoor access to the big Korean EPCs.

Year	Target	Country	Price	Water portfolio contribution
2023	Kemco Systems	USA	-	Design and manufacture of custom-engineered industrial water recycling systems
2022	DS21 Co., Ltd.	S. Korea	\$9.2m	Design and manufacture of wastewater, stormwater, and process water solutions
2022	Compass Water Solutions	USA	\$12.5m	Membrane-based treatment systems, including oil-water separators and RO units
2022	Index Water Systems	Jordan	-	IP around water/wastewater treatment planning and design in the Middle East
2022	General Rubber LLC	USA	\$19.7m	Non-metallic expansion joints and flow control products

Source: GWI WaterData

not a good fit or if it’s not a good economic return for our shareholders, then we just won’t do it.”

The current growth trajectory is likely to mean the company garners an increasing amount of attention from thematic water funds – albeit those with some flexibility around the purity of the companies

they take exposure to. “That’s an interesting series of discussions that are in front of us,” commented Gleason. “I believe that water will be one of our largest areas for shareholder value creation over the next year or two. It’s one of the reasons why we continue to invest heavily today for margin growth tomorrow.” ■

ANATOMY OF AN INDUSTRIAL WATER BUSINESS

Thanks to a series of canny acquisitions, CECO’s industrial water capabilities range from oily water separation, ultrapure water supply and condensate polishing through to desalination. It now wants to diversify away from a historical bias towards custom-engineered systems by increasing the proportion of short-cycle sales.



Nasdaq ticker: CECO
CEO: Todd Gleason

2023 full-year revenue forecast: \$525m+
2023 adjusted EBITDA forecast: \$55m+

Industrial air (~40%) Industrial water (~30%) Energy transition (~30%)



Acquired 2022
Annualised revenues: ~\$13m
Manufacturer of non-metallic expansion joints and flow control products

Legacy water brands:



Acquired 2022
Annualised revenues: ~\$10m
Membrane-based water and wastewater treatment systems including oil-water separators and reverse osmosis units



Acquired 2022
Annualised revenues: ~\$12m
Oily wastewater, process water, and produced water treatment systems. Approved vendor for major Korean EPCs



Acquired 2023
Annualised revenues: ~\$22m
Designer and manufacturer of custom-engineered industrial water recycling and energy conservation systems

Digital IP in the Middle East:



Source: CECO Environmental