CLEANING UP IN medical waste

Stericycle's Steri-Safe program includes CD-Rom-based self-training modules on subjects such as handling hazardous substances or how to protect oneself from pathogens.

When an American has a blood test at the doctor’s, a filling at the dentist’s, or even a leg removed in a hospital, there is a one-in-five chance that Stericycle will pick up the pieces – literally. Stericycle (NASDAQ: SRCL) is North America’s largest provider of regulated medical waste management services. This includes collecting, sterilising and disposing of medical waste, ranging from wet-wipes and syringes to test tubes and even anatomical material. In addition, it provides specialized storage containers and, increasingly, safety training and assisting regulatory compliance via its Steri-Safe program.

It sounds gruesome, but as Mark Miller, Stericycle’s president and CEO, points out, the business is much more like an express delivery service than garbage collection. The waste is pre-sorted by Stericycle’s clients. After it is collected in one of nearly 1,000 specialist vehicles, it is barcoded and tracked until it has been treated and disposed of in landfill at one of the company’s 39 treatment centers.

“Our professional approach is important to our clients, because the legal liability in case of error far outweighs the cost of our service,” says Miller. “They want a company that’s financially sound, and has sophisticated systems for tracking and record-keeping.”

Stericycle has more than 283,000 customers. Some 4,800 hospitals and research centers, spending $25,000-30,000 a year, account for 42 percent of revenues. The rest are doctor and dentist practices, spending $700-800 a year. “This business is incredibly granular, which gives us very predictable earning streams,” says Miller. “It’s non-cyclical, because demand is there regardless of economic cycles, and we have 95 percent customer retention. This has helped us meet or exceed expectations every quarter since our foundation.” Revenues in 2001 rose 10.9 percent to $359 million.

**Bold acquisition**

Stericycle’s foundation, in 1989, came about largely due to the Medical Waste Tracking Act, 1988, which mandated special procedures – for example, sterilisation or incineration – for material that has come into contact with blood and other body fluids. Before 1988, medical waste was just thrown in the bin, and so there was no specialist market. Not only does such waste have to be disposed of in the correct manner, but this must be demonstrable, hence the waste must be tracked from source to disposal.

From the early 1990s, general waste disposal giants muscled in and used
Since 1993, Stericycle has acquired more than 60 rivals – including then-market leader BFI, now fully integrated with Stericycle’s infrastructure. In January, Stericycle completed its latest acquisition – of Scherer Healthcare Inc. – which it bought for $41.5 million.

These acquisitions have brought economies of scale. “The economics of this business significantly favor size and scale,” says Mark Miller, president and CEO of Stericycle. “It means we can price at the same level as smaller competitors and be more profitable.”

Transport costs are high, so the more customers a vehicle can visit in the shortest possible distance, the better. Stericycle has proprietary software, Biotrack, to optimize vehicle routes.

Waste processing also benefits from economies of scale: a single ETD plant can process the medical waste from several states. In 2001, tighter emissions controls required owners of medical incinerators to spend more than $30,000 installing emissions-testing equipment – affordable for Stericycle, but prohibitively expensive for individual hospitals.

The cost of support services, such as Stericycle’s sophisticated waste-tracking system, can be spread over many customers. And the company’s proprietary database of hundreds of thousands of existing and potential customers allows highly structured marketing campaigns.

Analysts agree that size matters. “Economies of scale are prevalent in Stericycle’s business and are likely to discourage major new entrants while moving the business to a higher level of profitability,” says Matthew Litfin at William Blair.

Putting safety first
A further boost to margins will come from Steri-Safe, Stericycle’s OSHA (Occupational Safety and Health Act) compliance program. This includes CD-ROM-based self-training modules on subjects such as handling hazardous substances as well as software tools.

The basic Steri-Safe subscription is an incremental $120 a year, rising to $1,000. The service saves so much time and risk that cost is of little importance, Miller explains. As a result, Stericycle can make margins of 75 percent. Taking on Steri-Safe could double the revenue of a small medical practice.

Stericycle’s sophisticated marketing database enables carefully honed campaigns. Small accounts are growing at 8-10 percent a year, and only one in six has so far bought Steri-Safe. Miller expects Steri-Safe penetration to grow at 1.5-2 percent a quarter. Large account revenues from all activities are growing at 4-5 percent a year, he adds.

With margins on the increase, single-digit headline revenue growth will bring double-digit earnings growth, Miller predicts. Acquisitions will add to this. On average, Stericycle acquires a company every seven or eight weeks. Most of these are small ‘mom and pops’, which are integrated into the company. “It’s a pretty proven process we go through,” he adds.

International expansion
Increasingly, Stericycle is using its patented technology, Electro-Thermal-Deactivation (ETD), to destroy medical waste. ETD is the basis of international business for Stericycle, which has set up a subsidiary in Canada. It also has joint ventures using ETD in Mexico, Argentina and South Africa, and has licensed ETD in Brazil, Australia and Japan.

ETD uses low-frequency radio waves to heat the waste to temperatures that destroy viruses, bacteria, etc., without melting any plastic content, which can be recycled. There are no emissions, so the process is very environmentally friendly.

“Excluding Canada, international business is 3-4 percent of our total, but in the longer term it’s a very meaningful opportunity,” says Miller. “We believe Japan, for example, is a larger market opportunity than the U.S., because prices there are not so deflated.”

And in the U.S, Miller is confident about Stericycle’s market position. “We’ve grown to a size where we have a long-term, sustainable competitive advantage,” he says. “If we invest just a few percent in R&D, marketing, etc., we achieve results none of our rivals can match.”

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