

ROBUST BACKLOGS FUEL SERVICING CONTRACTS AND M&A ACTIVITY

HVAC SERVICES SECTOR UPDATE | NOVEMBER 2023



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HVAC Services

Robust Backlogs Fuel Servicing Contracts and M&A Activity

KEY SECTOR TAKEAWAYS

Capstone Partners' Industrials Group is pleased to share its Heating, Ventilation, and Air Conditioning (HVAC) Services report. As economic headwinds have persisted, merger and acquisition (M&A) activity in the HVAC Services sector has moderated. However, the space has continued to draw buyers with its predictable, recurring revenues. A recovery in transaction volume is anticipated heading into 2024, as demand is inelastic for ongoing maintenance services and more energy efficient retrofit requirements have continued to grow. Additional key report takeaways are outlined below.

1. Backlogs have grown significantly year-over-year (YOY) as a result of pent-up demand in the Commercial space.
2. Contract renewals within the U.S. have remained steady and nearshoring has increased domestic supply chain capacity, which has bolstered the HVAC Services space.
3. Continued government environmental regulation and increased software adoption in the HVAC space are expected to continue propelling demand for maintenance and repair services.
4. Private strategic buyers and private equity sponsors have pursued expansion namely through roll-up acquisitions in year-to-date (YTD) 2023.
5. The HVAC Services market has remained highly fragmented, which has allowed financial buyers to effectively establish platform investments in remunerative segments using buy-and-build strategies.
6. M&A demand for residentially-focused HVAC Services players has remained the most coveted as these entities have been viewed as having the strongest levels of predictable, recurring revenue.

Capstone Partners has developed a full suite of corporate finance solutions, including, financial advisory services, merger and acquisition advisory, debt advisory, and equity capital financing to help privately owned businesses and private equity firms navigate through each stage of a company's lifecycle.

To learn more about Capstone's wide range of advisory services and HVAC Services sector knowledge, please [contact us](#).

ECONOMIC PRESSURES ENDORSE ACTIVE M&A PIPELINE

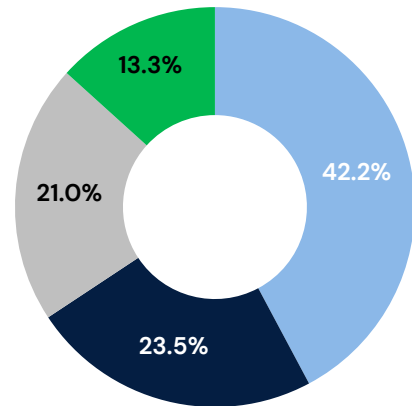
Despite recessionary headwinds and a tight lending environment, U.S. real gross domestic product (GDP) increased 2.1% and 4.9% in Q2 and Q3 2023, respectively, according to the Bureau of Economic Analysis.¹ However, inflationary pressures have persisted, with real disposable personal income decreasing 1% quarter-over-quarter in Q3 (U.S. Bureau of Economic Analysis)—challenging spending on HVAC equipment upgrades. Regardless, HVAC maintenance and repair services, which have comprised 23.5% of 2023 sector revenue (IBISWorld)², remain steady and are deployed to extend equipment lifetime. Despite a challenging economic backdrop, HVAC Services players have continued to garner increased demand, evidenced by a robust pipeline of forecasted work.

Backlogs have grown significantly due to pent-up demand in the Commercial space. Public players, such as Comfort Systems (NYSE:FIX) and Tutor Perini (NYSE:TPC), have benefited from healthy levels of contracted work, with their backlogs rising 50% and 27% YOY, respectively, according to their most recent earnings calls.^{3,4} Scaled sector participants with streamlined processes have limited the ability for smaller sector participants with fewer competencies to bid for larger contracts. “We’ve reached a point where as one of maybe two players in town that can do a major job, we’re increasing our prices and demanding contract changes, which we have forced through,” commented Ronald N. Tutor, CEO of Tutor Perini, in its Q2 earnings call. In contrast, many middle market players focus on providing niche services to specialized end markets. This affords the continual fragmentation of the space and encourages small and medium-sized enterprises (SME) to leverage inorganic growth to geographically expand and add offerings.

Nearshoring has received an increased focus among sector players post-pandemic. EMCOR (NYSE:EME), a major service provider, has shifted its focus to its U.S. business, with revenues in its U.S. Building Services segment reaching \$775 million in Q2 2023, representing a 12.9% increase YOY, versus \$106 million in its U.K. segment, a 7.4% reduction YOY, according to its most recent earnings report.⁵ The move towards reshoring will likely support critical supply chain resistance and capacity expansion as contract renewals within the U.S. remain robust.

Service Providers Reliant on New Construction (Percent of 2023 Sector Revenue)

- New Construction HVAC Installations
- HVAC Maintenance & Repairs
- Existing Structure HVAC Installations
- Refrigeration Installations, Maintenance, & Repair



Source: IBISWorld and Capstone Partners

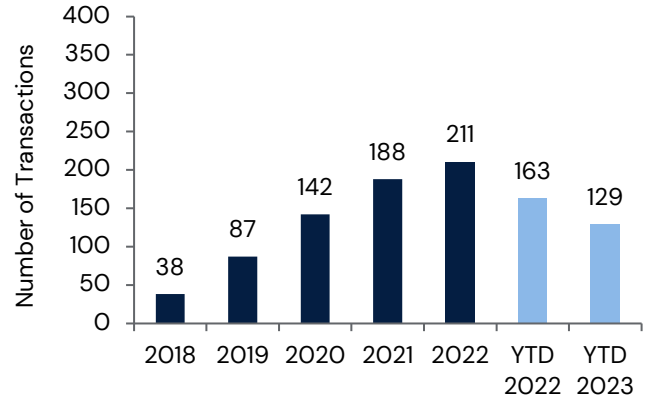
Significant legislative developments, including the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and the Clean Air Act (CAA), have addressed issues regarding hazardous emissions and the depletion of Earth’s ozone layer. The new regulations have limited the functionality of outdated HVAC equipment, requiring upgrades, with regulators calling for new stationary sources to be built with the best-in-class technology, according to a U.S. Environmental Protection Agency (EPA) report.⁶

Tax credits have driven the demand for upgrades from older, less efficient HVAC software infrastructure to the latest enhancements. Notably, APi Group (NYSE:APG), a leading public services company, has implemented its inspection first model across additional branches to prioritize customer relationships and higher margin revenue opportunities. As a result, EBITDA margins grew from low single digits to mid-20% in a ten-year span, according to its Q2 earnings transcript.⁷ Most competitors focus on lower margin, large scale installation jobs on nearly completed buildings, whereas APi’s targeted inspection work on existing facilities generates \$3–\$4 of service work for every \$1 of core inspection work, according to its earnings presentation.⁸

PRIVATE STRATEGICS AND SPONSORS BUOY M&A ACTIVITY

Deal activity in the HVAC Services space has declined 20.1% YOY to 129 transactions announced or completed through YTD 2023. However, sector deal volume has outperformed broader M&A markets, which experienced a 25.2% YOY volume decline through Q3, according to Capstone Partners. Private strategics and sponsors have remained active in the space, despite the difficult lending environment and economic backdrop. Uncertainty regarding the health of the global economy has divided the buyer universe, as public strategics have slowed acquisition pursuits while private strategics and sponsors have actively pursued roll-up opportunities. Private strategics and private equity buyers have led acquisition activity to-date, comprising 36.4% and 44.2% of deal activity, respectively. Sponsors have been attracted to the recurring revenue profile of many potential target companies.

HVAC Services M&A Transaction Volume



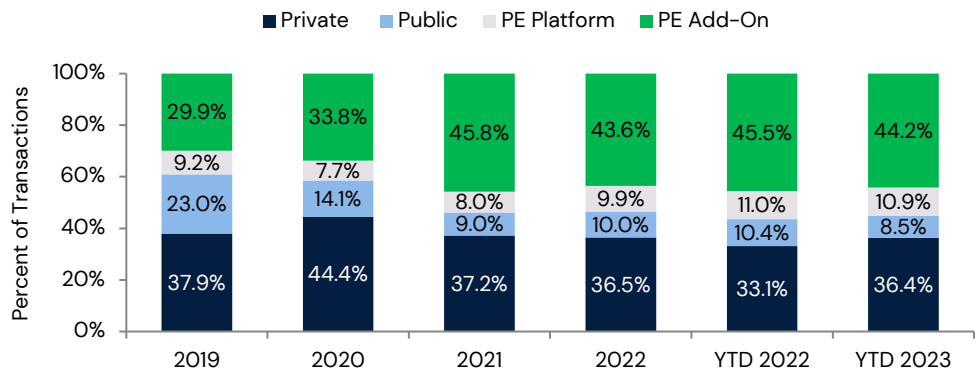
Year-to-date (YTD) ended October 5
 Source: Capital IQ, FactSet, PitchBook, and Capstone Partners

The HVAC Services market has remained highly fragmented, which has allowed financial buyers to effectively establish and grow platform investments in remunerative segments using buy-and-build strategies. Private equity firms can often provide the financial support and operational expertise required to accelerate the growth of a company. The robust pricing environment has attracted financial and strategic buyers to the space as high quality sector players have garnered premium valuations. HVAC Services M&A deals have commanded an average revenue multiple of 0.9x and an EBITDA multiple of 11.0x from 2022 to YTD 2023, representative of favorable deal activity for sellers in the current market. Public companies, similarly, have traded at an average revenue multiple of 0.8x and an EBITDA multiple of 11.6x.

Residential HVAC services have been a focal point for consolidation as they provide recurring revenues through bi-annual inspections, constant maintenance, and repairs. Morgan Stanley Capital Partners-backed Sila Heating & Air Conditioning has been a prominent consolidator, having announced or closed six transactions in YTD 2023. With its acquisitions this year, Sila has expanded its geographic footprint in the Midwest U.S. and fortified its foothold in New England. In its recent acquisition of Levine & Sons, CEO of Sila, Jason Rabbino, reaffirmed the company’s dedication to growing local brands and operations, while retaining and developing local leadership teams, according to a press release.⁹ Despite the high cost of capital, private equity firms have remained committed to the space and have been actively investing in the sector.

Private Equity Continues to Utilize Add-On Acquisitions to Bolster Portfolio Holdings

The prevalence of private equity-backed companies in the sector has created a significant opportunity for add-on deals as sponsors look to integrate smaller companies to drive increased value.



Year-to-date (YTD) ended October 5
 Source: Capital IQ, FactSet, PitchBook, and Capstone Partners

PRIVATE EQUITY INCREASES SECTOR EXPOSURE

Private equity firms have continued to deploy capital towards the HVAC Services sector, accounting for 53.1% of deals in YTD 2023, despite a markedly down year in the broader market for private equity activity. Abundant levels of dry powder have developed a healthy backdrop for private equity transaction activity. Sponsors have historically been attracted to the sector, despite adverse economic conditions, and have recently continued their exposure, with several takeaways outlined below.

- Private equity firms have actively enhanced portfolio holdings through add-on acquisitions, leveraging funding to break into new geographies, add technologies or capabilities, capitalize on operational synergies, and bolster scale.
- Recessionary resilience, recurring revenues, and strong tailwinds including energy efficiency and indoor air quality have continued to attract private equity buyers to the space.
- With a favorable pricing environment, private equity firms have sought to close acquisitions at discounted valuations through year end and into 2024.



Leading national building solutions provider, Crete Mechanical Group (CMG), has made two acquisitions in the HVAC Services space through YTD—Versatile Refrigeration (October) and Loellke Plumbing (June), for undisclosed sums. The acquisition of Versatile Refrigeration marks the seventh acquisition CMG has completed since receiving investment from Ridgemont Partners in June 2022 (undisclosed). Through the acquisitions, CMG expands its partner network to Texas, Illinois, and Missouri, while also broadening its expertise within the sector, according to a press release.¹⁰

Northwinds Services Group, an industry-focused HVAC and plumbing services group, backed by TruArc Partners, has acquired three HVAC service providers—Rebmann Plumbing, Heating & Air Conditioning (May), LeProvost Plumbing, Heating & Cooling (July), and All-Temp Systems Mechanical (August), all for undisclosed sums. The acquisitions provide Northwinds with enhanced scale and capacity across Massachusetts and New York, adding to the existing geographical footprint of Northwinds’ umbrella of companies across the U.S, according to a press release.¹¹



Blackstone (NYSE:BX)-backed Legence Holdings acquired California-based mechanical contractor, A.O. Reed & Company (September), for an undisclosed sum. A.O. Reed & Co.’s advanced HVAC technologies will help enable Legence in delivering “next-generation decarbonization solutions that result in better buildings, lower emissions, and healthier occupants,” according to the deal’s press release.¹² A.O. Reed marks Legence’s fifth portfolio addition in YTD 2023, aligning with its strategy to become a premier provider of decarbonization solutions.

The Orion Group, a portfolio of Alpine Investors, has acquired the Owens Company, a family-owned facility services business (July) for an undisclosed sum. Founded in 1957, Owens joins a growing portfolio of heavy mechanical-focused businesses in the HVAC Services space across the U.S. and has marked Orion’s first investment in the Minnesota area, according to the deal’s press release.¹³ In July, Orion also acquired commercial and industrial HVAC maintenance provider, Redblue, for an undisclosed sum, which has expanded Orion’s geographic reach to the Carolinas.

SELECT M&A TRANSACTIONS

Date	Target	Acquirer	Target Business Description	Enterprise	EV / LTM	
				Value (mm)	Revenue	EBITDA
10/03/23	Versatile Refrigeration	Crete Mechanical	Provides commercial, industrial, and residential HVAC and refrigeration services.	-	-	-
09/19/23	A.O. Reed & Company	Legence Holdings	Operates mechanical heating, ventilating, and air-conditioning services.	-	-	-
09/18/23	Heating and Cooling networks of Equans	Swiss Life; Greencoat Capital	Provides heating and cooling networks in the U.K.	\$322.2	-	-
09/11/23	Urd Klima Sandnes	Instalco (OM:INSTAL)	Offers ventilation, heating, and cooling systems solutions.	-	-	-
08/18/23	All-Temp Systems	Northwinds Services	Provides heating, air conditioning, ventilation and plumbing services.	-	-	-
08/01/23	Santapaul	CoolSys	Offers commercial and industrial HVAC, refrigeration, plumbing, and energy services.	-	-	-
07/25/23	LeProvost Plumbing Heating & Cooling	Northwinds Services	Services both residential and commercial HVAC needs.	-	-	-
07/12/23	Environmental Systems	Fidelity Engineering	Provides integrated systems services.	-	-	-
07/01/23	Redblue	Alpine Investors, Orion Group	Provides HVAC maintenance services in the Carolinas.	-	-	-
07/01/23	Owens Companies	Alpine Investors, Orion Group	Provides HVAC services intended for both commercial and residential sectors.	-	-	-
06/01/23	Loellke Plumbing	Crete Mechanical	Offers plumbing heating, and cooling services for the utilities sector across Illinois and Missouri.	-	-	-
06/01/23	American Air & Heat	Len The Plumber	Provides residential HVAC services.	-	-	-
05/22/23	Park Ridge Unique Indoor Comfort	Sila Heating & Air Conditioning	Installs and repairs heating and cooling systems.	-	-	-
05/16/23	Service Specialists	CMS Nextech	Provides heating and air conditioning services intended for commercial businesses.	-	-	-
05/15/23	Rebmann	Northwinds Services	Provides plumbing, heating and air conditioning services for both commercial and residential customers.	-	-	-
05/01/23	HVH Mechanical Partners	Service Logic	Provides heating, ventilation and air conditioning (HVAC) services headquartered in Covington, Georgia.	-	-	-
04/28/23	The SEER Group	Genstar Capital	Provides commercial HVAC, electrical, and plumbing maintenance and repair services.	-	-	-
04/25/23	Bulldog Ventures	Sila Heating & Air Conditioning	Installs, repairs, and maintains heating and cooling systems.	-	-	-
04/21/23	Sureserve (AIM:SUR)	Cap10 Partners	Provides compliance and energy services in the U.K.	\$269.0	0.7x	8.6x
04/11/23	Jackson Comfort Systems	Sila Heating & Air Conditioning	Provides heating, cooling, and plumbing services to residential and commercial clients.	-	-	-
03/01/23	Thermonova	Solar (CPSE:SOLAR B)	Distributes hardware, plumbing, and heating equipment and supplies.	\$41.9	-	15.3x
01/11/23	CCH Holdings	Sila Heating & Air Conditioning	Provides installation, repairs, and replacements of heating and air conditioning equipment.	-	-	-
01/02/23	Uponor (HLSE:UPONOR)	Oras Invest	Provides plumbing, indoor climate, and infrastructure solutions in Europe and North America.	\$1,429.6	1.0x	7.0x

Source: Capital IQ, PitchBook, FactSet, and Capstone Partners

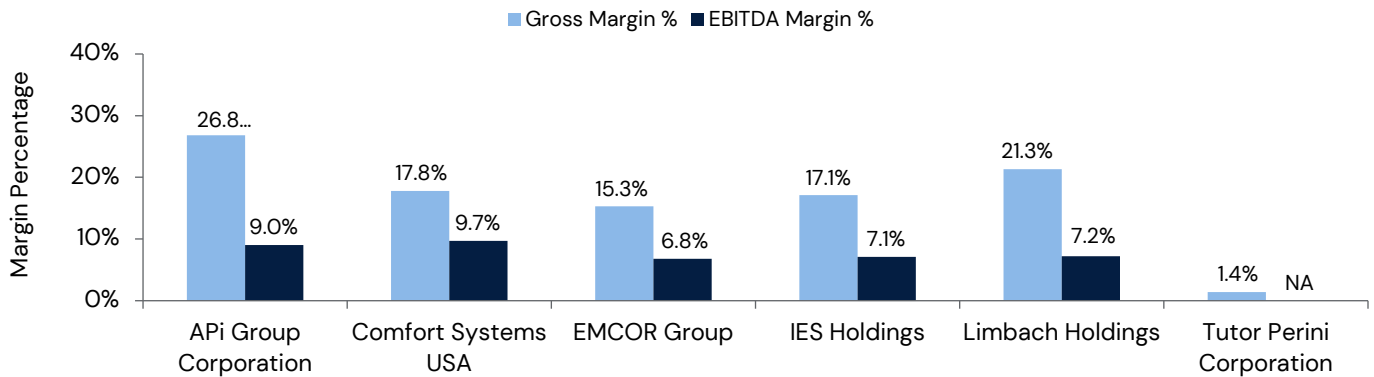
PUBLIC COMPANY DATA

Company	Price 10/05/23	% 52 Wk High	Market Cap	Enterprise Value	LTM			EV / LTM	
					Revenue	EBITDA	Margin	Revenue	EBITDA
APi Group Corporation	\$26.00	87.9%	\$6,130.4	\$9,396.4	\$6,823.0	\$613.0	9.0%	1.4x	15.3x
Comfort Systems USA, Inc.	\$166.03	86.3%	\$5,921.6	\$6,146.2	\$4,708.3	\$455.5	9.7%	1.3x	13.5x
EMCOR Group, Inc.	\$204.40	89.8%	\$9,634.4	\$9,701.0	\$11,712.2	\$793.3	6.8%	0.8x	12.2x
IES Holdings, Inc.	\$69.55	90.6%	\$1,404.3	\$1,487.0	\$2,345.6	\$167.6	7.1%	0.6x	8.9x
Limbach Holdings, Inc.	\$28.12	74.6%	\$309.4	\$303.5	\$511.7	\$37.0	7.2%	0.6x	8.2x
Tutor Perini Corporation	\$7.54	78.5%	\$391.9	\$1,108.1	\$3,775.6	NM	NA	0.3x	NA

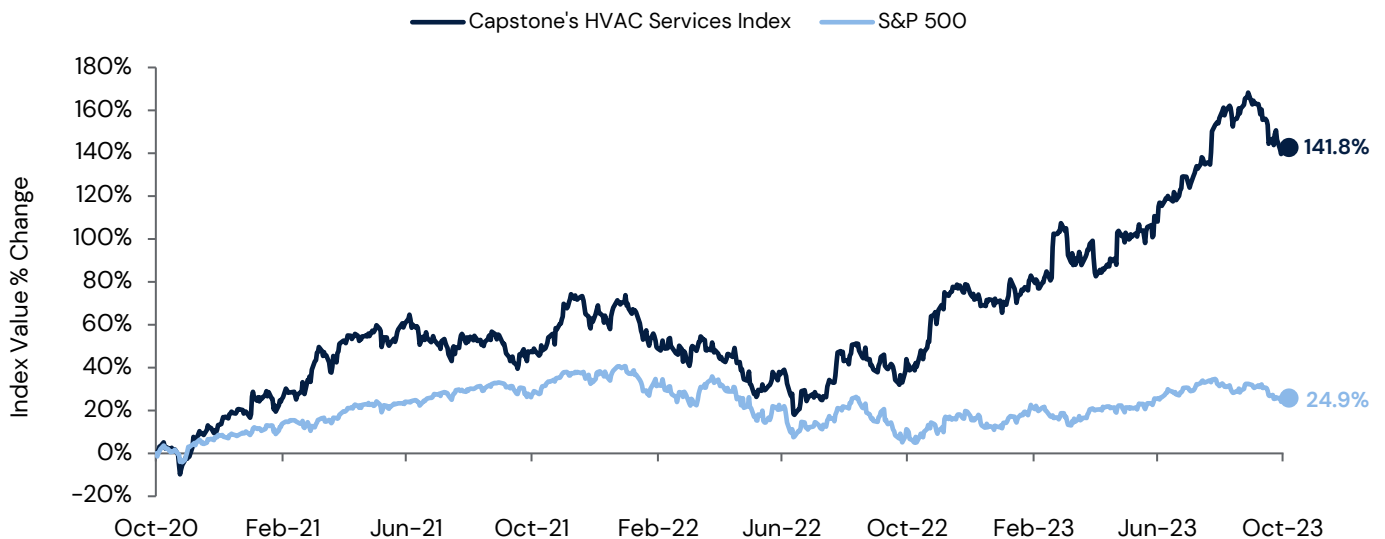
Mean	8.0%	0.8x	11.6x
Median	7.2%	0.7x	12.2x
Harmonic Mean	7.8%	0.6x	11.0x

EV = enterprise value; LTM = last twelve months
 \$ in millions, except per share data
 NM = Not Meaningful

Last Twelve-Month Margin Performance



Capstone's HVAC Services Index Value Growth Outpaces S&P 500 in the Last Three Years



Source: Capital IQ and Capstone Partners as of October 5, 2023



BUYER UNIVERSE

Capstone has built relationships with and tracked buyers that have been highly acquisitive in the HVAC Services sector, particularly those that have completed notable M&A transactions. Our sector knowledge and network provides us with unique insights into this buyer universe and industry and growth drivers for the companies within it.

Leading Strategic Buyers



Leading Financial Buyers



Source: Capstone Partners



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Ted is a Managing Director at Capstone Partners. Prior to joining Capstone in 2010, Ted ran the corporate finance practice in the Central region for Morgan Stanley Smith Barney’s Capital Strategies Group and its predecessor, Citi Capital Strategies. He has over 25 years of experience working with businesses across a variety of industrial and tech-enabled markets and has focused interest in working with HVAC and energy management related businesses. Early in his career, Mr. Polk also provided valuation advisory services for an entity now owned by Duff & Phelps and was a lender to the Utility industry in the Corporate Banking Group at The Bank of New York and its predecessor Irving Trust Company.

Ted is an active public speaker on the topic of business exits and recapitalizations of privately owned businesses and is a frequent recipient of industry awards for his advisory services. Ted was recognized by the Global M&A Network for his participation in both the Canadian Deal of the Year in 2022 and the Aerospace and Defense Deal of the Year in 2021. He was similarly recognized in 2018 for his involvement in the USA Recapitalization Deal of the Year, in 2017 for his participation in the U.S. Corporate M&A Deal of the Year and in 2015 for USA Recapitalization Deal of The Year. Previously, he was also recognized by the M&A Advisor in 2016 for his role on the Professional Services Deal of the year and was also previously recognized by this organization for his role on transactions awarded the Middle-Market M&A Deal of the Year, the Middle-Market M&A Financing Deal of the Year and the Cross-Border Middle-Market Deal of the Year.



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FIRM TRACK RECORD

Capstone Partners has represented a diversified group of HVAC and infrastructure-related companies that serve both Residential and Commercial marketplaces. Our Industrials Group has an active market presence in the HVAC sector, allowing Capstone to provide HVAC companies with experienced, up-to-date market data and access to key decision makers among the sector’s most active acquirers and investors.

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ENDNOTES

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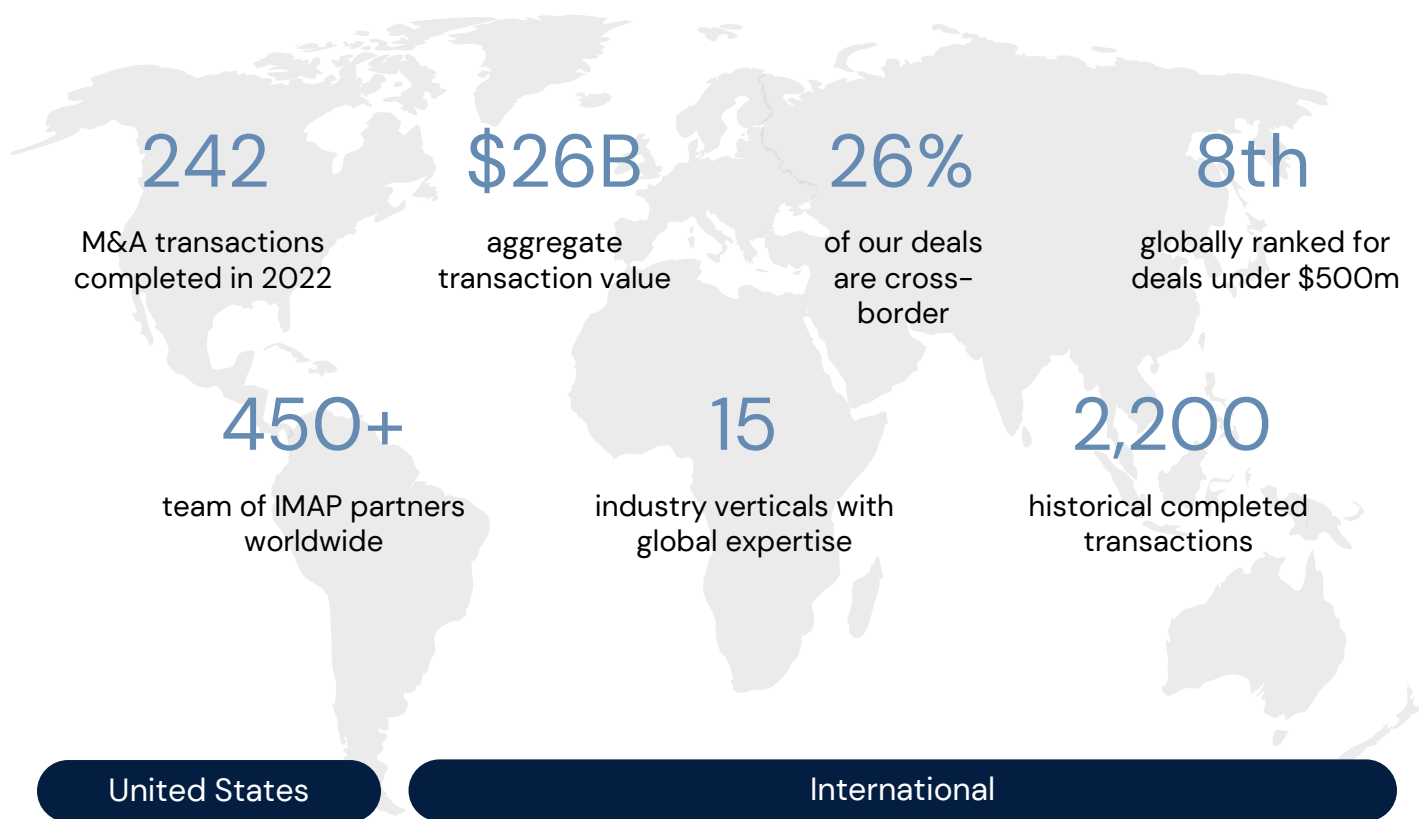
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