THE BUY-AND-BUILD STRATEGY:

Still an Effective Way to Generate Returns in the Facility and Residential Services Space

Introduction

The facility and residential services (F&RS) sector has experienced increased activity and premium valuations over the past five years. This level of interest has been supported by attractive sector economics; however, it has also caused many evaluating the sector to question whether there is still an opportunity to pursue.

While interest has been strong, and anecdotes of aggressive buyer behavior are common, this paper explores two fundamental questions: (1) Does the F&RS sector still offer compelling opportunities to buy and build new platforms; and (2) Should anecdotes of aggressive buyer behavior turn would-be buyers away?

Houlihan Lokey is a M&A market leader in the United States with dedicated coverage of the F&RS sector, giving us a unique vantage point into the ways our clients have successfully built enterprise value. Our experience leads us to believe the F&RS sector still offers compelling opportunities, especially for those looking to create value through a buy-and-build strategy. Recent successes and consolidations do in fact provide a useful blueprint for identifying the most effective ways to create highly profitable platforms poised for continued growth in the sector. Meanwhile, careful M&A exit process design can ensure that successes and value creation are not lost to buyer fear concerning recent aggressive sector activity.

Houlihan Lokey's Facility & Residential Services Team

Houlihan Lokey's dedicated Facility & Residential Services practice has advised companies and clients across more than 20 subsectors over the past few years. We have earned a reputation as a thought leader in the industry and a partner to our clients, having achieved outstanding results in M&A advisory, capital raising, and financial and valuation advisory services for companies in our sector.

Our clients run the gamut from private and sponsor-backed companies to large, publicly traded corporations. We have deep experience working with family/founder-owned businesses as well as companies owned by institutional investors.

We understand the unique value-drivers and characteristics of companies across multiple subsectors in this essential, outsourced services industry. Our disciplined, intellectually driven approach to process strategy and deep industry relationships help achieve the strategic goals of our clients. Our experience and market intelligence are invaluable—particularly in complex macroeconomic environments—when leveraged to maximize valuation and deal certainty for our clients.

Subsector Coverage

Managed Services

- Aviation Site Services
- Catering and Foodservice
- Equipment-as-a-Service
- Exterior Care
- Grounds Management
- Interior Maintenance and Care
- Janitorial and Sanitation
- Laundry Services
- Multisite Property Services
- Pest Control
- Response and Restoration
- Security Services

Technical Services

- Asset Management
- Automation and Controls
- Code Compliance
- Elevator Services
- Equipment Care
- Fire and Life Safety
- Flooring
- HVAC Services
- Mechanical, Electrical, and Plumbing
- Roofing and Siding
- Utility and Energy Management
- Windows and Doors

Featured Transactions

Conhagen
Rotating Equipment Specialists
has been acquired by
Ovation Holdings, Inc.
a portfolio company of
Warren Equity Partners
Sellside Advisor

TSS Technical Safety Services
a portfolio company of
the edgewater funds
JZ | Partners
has been acquired by
Levine Leichtman Capital Partners
Sellside Advisor

FusionSite
has been acquired by
The Cynosure Group
Sellside Advisor

Southland
has acquired
Brandt
Buyside Advisor

Global Industrial Services Inc.
has been acquired by
Pritchard Industries
A Building Services Company
Sellside Advisor

Pritchard Industries
A Building Services Company
a portfolio company of
Alvarez & Marsal Capital
has been acquired by
Littlejohn & Co.
Sellside Co-Advisor

Air Pros
Residential & Commercial Air Conditioning Services
Revolver & Term Loan
Acquisition Financing & Dividend Recapitalization
$185,000,000
Exclusive Placement Agent

Pamplona Capital Management
has acquired
eet
Buyside & Financing Advisor

RMA Companies
Every Project Matters | www.rmacompanies.com
has been acquired by
Oceansound Partners
Sellside Advisor

Platinum Equity
has engaged in a continuation fund transaction involving
United Site Services
Fairness Opinion

Tombstones included herein represent transactions closed from 2020 forward.

Leading Independent, Global Advisory Firm

Houlihan Lokey is the trusted advisor to more top decision-makers than any other independent global investment bank.

HLI
LISTED
NYSE

2,500+	35	$6B+	$1.8B	~25%	NO
EMPLOYEES	LOCATIONS	MARKET CAP[(1)]	ANNUAL REVENUE[(2)]	EMPLOYEE-OWNED	DEBT

Corporate Finance

- No. 1 Global M&A Advisor Under $1 Billion
- Leading Capital Markets Advisor, Raising More Than $100 Billion in the Past Five Years

2022 M&A Advisory Rankings
Global Transactions Under $1 Billion

Advisor		Deals
1	**Houlihan Lokey**	**381**
2	Rothschild	369
3	JP Morgan	217

Source: Refinitiv. Excludes accounting firms and brokers.

Financial Restructuring

- No. 1 Global Restructuring Advisor
- $3.0 Trillion of Aggregate Transaction Value Completed

2022 Global Distressed Debt & Bankruptcy Restructuring Rankings

Advisor		Deals
1	**Houlihan Lokey**	**58**
2	PJT Partners	30
3	Lazard	29

Source: Refinitiv.

Financial and Valuation Advisory

- No. 1 Global M&A Fairness Opinion Advisor Over the Past 25 Years
- 1,000+ Annual Valuation Engagements

1998 to 2022 Global M&A Fairness Advisory Rankings

Advisor		Deals
1	**Houlihan Lokey**	**1,232**
2	JP Morgan	1,030
3	Duff & Phelps, A Kroll Business	938

Source: Refinitiv. Announced or completed transactions.

Financial Sponsors Coverage

- No. 1 Global Advisor to Private Equity Firms
- 1,000+ Sponsors Covered Globally

2022 Most Active Global Investment Banks to Private Equity Firms

Advisor		Deals
1	**Houlihan Lokey**	**242**
2	Lincoln International	192
3	Deloitte	190

Source: PitchBook.

(1) As of March 2023.
(2) LTM ended December 31, 2022.

No. 1 M&A Advisor

Global Business Services Transactions

2022 M&A Advisory Rankings

All Global Business Services Transactions

	Investment Bank	Deals
1	**Houlihan Lokey**	**69**
2	Rothschild & Co	50
3	Lincoln International	37
4	Goldman Sachs	34
5	GCG	26

Source: Refinitiv. Excludes accounting firms and brokers.

LEADING GLOBAL INDEPENDENT INVESTMENT BANK

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- Dallas
- Houston
- Los Angeles
- Miami
- Minneapolis
- New York
- San Francisco
- Washington, D.C.

Europe and Middle East

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- Dubai
- Frankfurt
- London
- Madrid
- Manchester
- Milan
- Munich
- Paris
- Stockholm
- Tel Aviv
- Zurich

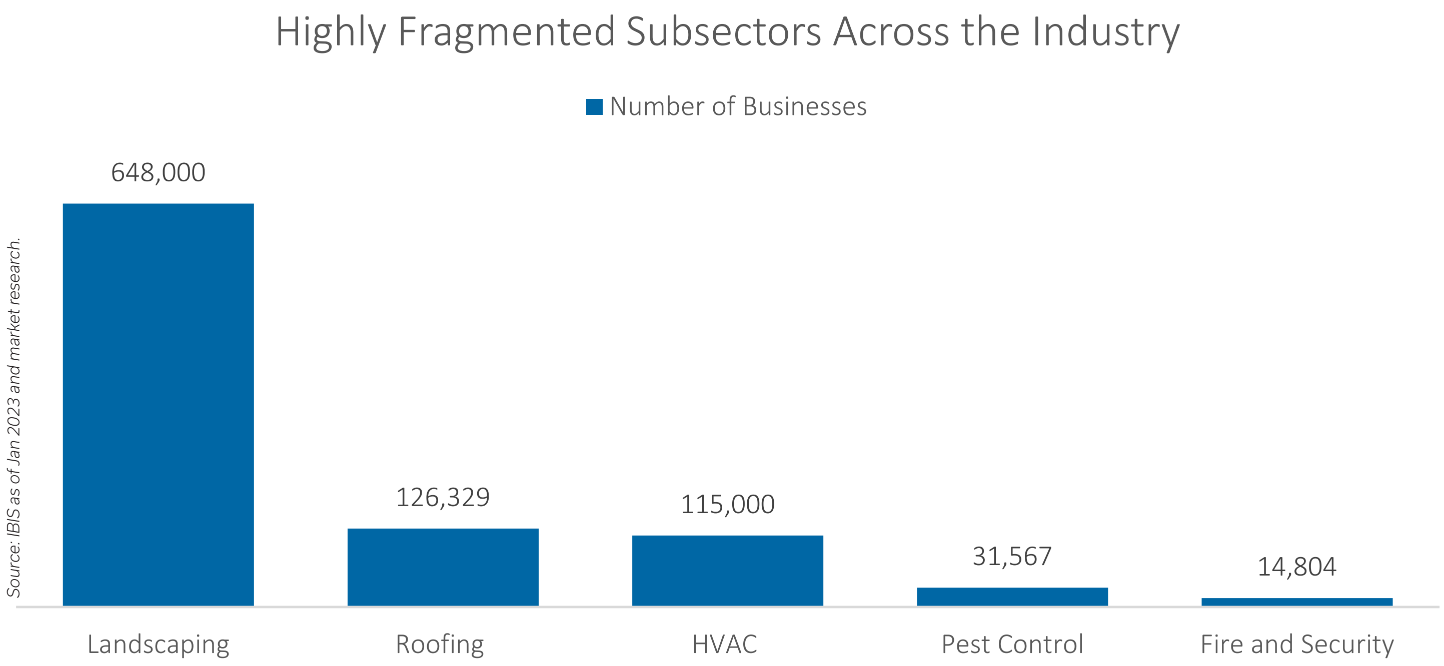
Asia-Pacific

- Beijing
- Fukuoka
- Gurugram
- Ho Chi Minh City
- Hong Kong SAR
- Mumbai
- Nagoya
- Osaka
- Shanghai
- Singapore
- Sydney
- Tokyo

A Large, Fragmented Market With Many Ways to Win

The facility and residential services sector has experienced widespread interest and activity from the financial sponsor community. This activity has resulted in a number of high-profile success stories as well as notable areas of consolidation.

Despite this, the sector remains highly fragmented, with a large number of smaller businesses operating across the breadth of essential services needed to maintain industrial and commercial facilities as well as residential properties. While seemingly niche, sector mapping supports a vast universe of businesses per major subcategory within our coverage universe. This fragmentation, combined with the recession-resistant characteristics inherent to a services business model, offers a compelling growth opportunity for years to come.



Attractive Investment Characteristics

Several key characteristics support an attractive F&RS sector for potential investors—and also enable a great opportunity for those seeking resilient and growing markets notwithstanding an uncertain economic backdrop.

Essential nature of services drives demand and growth. The majority of the services in question are non-discretionary, making them resilient to GDP and economic shocks. Many services, such as code compliance and fire and life safety, are mandated by law, ensuring consistent demand. Other services, like restoration, grounds management, electrical, and plumbing, benefit from addressing everyday safety and operational needs that cannot be delayed.

An element of counter-cyclicality enhances the resilient nature of these demand drivers, as facility and residential maintenance activity tends to expand in recessionary periods when new building is deferred and F&RS activity is increased to maintain, rather than replace, structures.

Stable, recurring revenue with strong margins. The essential and recurring nature of the services, along with the tendency to provide them via long-term contracts, means that these businesses can benefit from a high level of stability and predictable income. Whether service schedules are in place (e.g., janitorial or landscaping) or the service is driven by transactional demand, the revenue trend is incredibly consistent, as "small-ticket" needs (e.g., fixing a plumbing leak or providing overhead door maintenance) are serviced regularly and cannot be deferred.

Large, and often captive, customer base. While pure-play operators have plenty of market to focus on for their core service line, the cross-selling opportunity is also tremendous. The audience requires multiple services. Customers are also increasingly preferring to consolidate vendors for convenience and simplicity. For example, a homeowner might ask the HVAC technician to answer plumbing questions, or to include electrical services alongside building automation. Many services are also needed at regular intervals, such as janitorial and grounds management, often retained through long-term contracts. This creates a captive audience for potential upselling of new services.

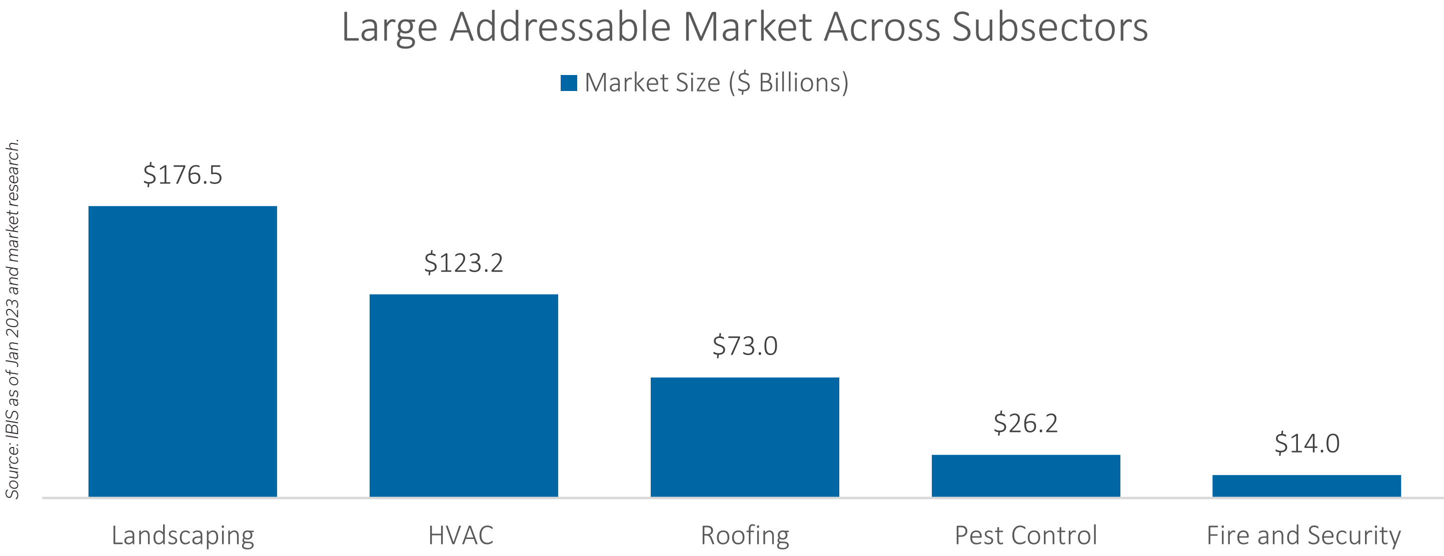
Significant Opportunity to Add Value

Although we have witnessed several success stories across the facility and residential services landscape in recent years, there is still enormous potential to drive growth by achieving scale in the sector.

$500 billion market for home services

Source: FrontDoor Q4 2021 Earnings Call.

Large addressable market and untapped subsectors. For example, here are more than 1.9 million home services providers in the U.S., spanning a broad range of subsectors. While there have been some high-profile transactions and consolidation activity in certain subsectors (e.g., HVAC; fire and life safety), other subsectors have largely been ignored by investors, despite enjoying similar investment characteristics. As the buyer universe has become more data-driven, the attractiveness of each sector is weighed on metrics such as revenue growth; revenue retention; gross margin and cost controls; and customer lifetime value and acquisition cost. Interestingly, each F&RS subsector can demonstrate similar metrics despite providing different services. Buyers continue to set their sights on additional F&RS markets as this statistical similarity between sectors becomes increasingly apparent.



Highly fragmented market of smaller local providers. Many providers of services are small businesses, often starting out as "mom-and-pop" operations. Although experts at providing their services, they may not have experienced certain business process enhancements that can be added through investment and scale, leaving substantial upside potential by investing accretive capital behind operations.

Processes and digital transformation. Historically flat revenue trends quickly pivot to sustainable growth once key processes are put in place. Examples include (1) a dedicated sales effort; (2) a dedicated marketing organization; (3) defined metrics and incentivized selling behavior; (4) cohesive systems that allow proactive versus reactive management; (5) direct cost controls, including both materials and labor; and (6) a long-term (versus short-term) view on back-office investment to support future operating leverage. Additionally, processes and scale offer a powerful data opportunity—whether monitoring and maintaining critical commercial systems or anticipating and servicing demand from a vast universe of individual residential homeowners—creating actionable insights that fundamentally change business performance and the resulting valuation paradigm.

Macroeconomic uncertainty makes this a good time to enter the market. Having enjoyed growth in recent years, and an uplift in valuations, operators are facing a more uncertain future in the short term as inflation and cost of living pressures temper economic growth. If valuations reset, there could be a very attractive opportunity for buyers. Many operators are considering exiting the market soon rather than facing the more challenging environment ahead (particularly after the uncertainties of COVID-19), presenting opportunities to buy quality businesses with strong upside potential.

A Blueprint for Success in the F&RS Sector

Private equity investors have entered the F&RS sector in recent years, acquiring a number of businesses to create platforms to expand geographic coverage, combine complementary services, and expand end-market presence. While there have been some notable big winners in the space, these have tended to be concentrated in certain subsectors, leaving other subsectors ripe with potential for similar achievements. And, even within the seemingly "picked-over" sectors, there is ample opportunity for investors looking to create enterprise value through scale and depth of service. With several examples of successful platforms established, investors can evaluate and learn from the strategies deployed by others to inform their own approach in the sector. To put it simply, with in excess of 100,000 targets in major subsectors, any amount of M&A activity that has occurred to date is only a small fraction of the opportunity ahead. Therefore, the fundamental thesis should not rely on availability of attractive assets but should rather focus on the continued opportunity to invest accretive capital into the sector.

Benefits of Scale

Increased scale within the sector can lead to an increasingly powerful business as a result of revenue growth from more efficient customer acquisition and margin expansion due to route-based and operational efficiencies.

Improved Customer Acquisition and Upselling

- Larger companies with dedicated sales functions can sell more effectively across geographies and service lines.
- This can enable them to pursue larger customers with multiple sites and multiple service needs.
- Dedicated marketing resources can also increase customer conversion rates and enable upselling.

Density Drives Operational Efficiency

- F&RS businesses benefit more than most from increased density in a particular geography. The larger the business, the more powerful the business model becomes.
- The more common infrastructure in a location, the more those resources can be leveraged to provide faster, better, and more consistent services to customers.
- Route-based logistics are a common business model for the sector, making increased route density an important driver of financial performance.

Economies of Scale

- Volume can enable businesses to achieve a higher margin for delivering services.
- By leveraging advantages like common infrastructure and volume-based discounts on purchases, businesses can achieve substantial cost savings.
- And, regarding digital transformation, the ability to capture and leverage data increases to a statistically significant population size as a company continues to scale. Route optimization, customer feedback, and predictive analytics, among other tools, all become valuable at scale.

Talent Acquisition

- In an industry driven by people, a proven growing platform can help to attract the best in talent.
- Scale affords more competitive employee benefits packages through increased purchasing power with providers.
- In a tight labor market, any recruitment advantage can provide an edge over competitors.
- It is important to note that not all businesses in the sector leverage a W-2 model, with many preferring to use a vendor-managed approach. Professionalization and scale also accrue significant benefits on a vendor-managed model, as best practices and "playbooks" can be identified and leveraged across an organization.
- Whether W-2 or vendor-managed, effective best practices and training can substantially shorten the ramp-up time for a new hire, instill key process controls, and drive employee success (and ultimately retention), all of which improve with scale.

Alternatives to Buy-and-Build: Possible Paths to Scale

Target Larger Opportunities

Buying an established company can be a shortcut to achieving scale and can mitigate some execution risk.

Pros	Considerations
• Delivers immediate scale upon acquisition. • Likely to already have organizational sophistication, including established executive team, infrastructure, and processes in place.	• Is there still an opportunity to drive impactful growth? • Incremental investment may not be able to "move the needle" as much as for a smaller company. • Higher price expectations are especially important in a market with constrained access to debt financing.

Target a High-Growth Opportunity

Buying a business that is already on the path to achieving scale is an option with a reduced organic risk profile.

Pros	Considerations
• If existing business fundamentals are delivering sustainable growth, these companies can have less upfront risk. • Rather than working to grow the business, an investor can focus on building organizational support and increasing sophistication.	• Growth can come at the expense of margins, so it is important to continue to focus on profitability to measure the value of changes to the business. • It is crucial to understand the reason for high growth to determine whether that growth is sustainable or cyclical.

Partner With a Proven Industry Executive

With a seasoned industry executive on board, investors can seek smaller assets to grow (sometimes from scratch), confident that they already have a leader ready to "plug and play."

Pros	Considerations
• The executive is likely to have a proven "playbook" for achieving growth, gained through prior experience. • An experienced industry figure can leverage reputation to establish credibility and open doors with acquisition targets.	• The success of this path relies on securing an executive with the right skills, experience, and reputation. • Successful companies with established management teams are less likely to sell to an investor that is augmenting management. • By starting with smaller targets, it can take longer to reach scale and the level of professionalization needed.

Pursue a Buy-and-Build Strategy

Buying a number of small businesses and integrating them to create a large platform can deliver scale and significant opportunities to add value.

Pros	Considerations
• This strategy has the broadest target universe to capitalize on the sector thesis, as it is suitable for companies with a range of attributes. • Acquisition multiples are likely to be muted for subscale opportunities (albeit creeping up in certain subsectors), making entry points more attractive (and still accretive even in the more mature subsectors).	• The success of a buy-and-build strategy depends on the ability to identify and execute on an accretive M&A story. • A solid base of infrastructure and strong management team are required to integrate new businesses and support platform growth.

Spotlight on the Buy-and-Build Strategy

In the current market environment, the buy-and-build strategy is particularly attractive. Although all acquisition strategies have drawbacks to consider, the challenges to the buy-and-build strategy are centered around internal capability, not market factors. Therefore, the factors influencing success are within the control of the investor and less reliant on external forces.

Recent activity in the market has also demonstrated ways to make this strategy successful, as well as pitfalls to avoid on the way, creating a blueprint for potential investors.

Determine the Ideal Targets for Buy-and-Build

Some companies are particularly well suited for integration into a larger platform.

- Companies with strong local relationships might particularly benefit from opportunities to penetrate new geographies through M&A, rather than pursuing organic growth. This can enable them to pursue larger customers with multiple sites and multiple service needs.
- By targeting subsectors with a large universe of smaller targets, investors have ample targets for a buy-and-build strategy, even if other sponsors also enter the space and compete for deals.
- Companies that have strong employee retention and culture are best placed to thrive and enable growth through operational improvements. Expanding a great culture to other companies in the platform can also be a critical competitive advantage.

Add Value, Not Just Revenue

We have already discussed the potential benefits of scale within the F&RS sector, but we would caution investors against building scale for the sake of scale alone. Each incremental acquisition should be value-accretive to the overall platform.

This could be achieved by strengthening existing services, adding new services, or expanding into new geographies. But adding revenue for the sake of it won't build overall enterprise value. Investors need to stay focused on the sustained pro forma organic growth profile (i.e., buying companies that are, or will soon be, growing) and on sustaining (or enhancing) the margin they are able to achieve on each dollar of revenue.

Integrate Intelligently

Integrating businesses to leverage common systems, processes, and infrastructure can be a rich source of value in a buy-and-build strategy. But it should be approached strategically. Understanding which integration activities are going to add the most value from day one can help to prioritize the integration steps.

Understand the Value of Your Brand(s)

Brand plays an important role in building and retaining customer trust and confidence, especially in providing essential services (and even more so, when providing services to national accounts). However, a common parent brand can also dilute underlying sub-brand value. So, when considering whether to rebrand all companies under a new parent brand, sponsors should consider the value of each brand carefully.

Do Not Overpay for Opportunities

Despite the recent buying activity within the sector, the market is far from mature. The size and fragmentation of the sector mean that there is still a vast supply of targets that exceeds demand. While investors should be careful not to overpay for a subscale target, there is no shortage of opportunity.

A Compelling Opportunity to Buy and Build

The facility and residential services sector is still ripe with opportunity to execute an effective buy-and-build strategy. But success depends on a detailed understanding of the sector and the factors that create successful platforms.

Recent activity in the market has demonstrated the potential pitfalls of the strategy, but also the considerable success that can be achieved. To win in this space, sponsors must remain focused on what drives, rather than detracts from, enterprise value.

If you wish to explore any of these topics in more depth, please do not hesitate to reach out to us for more guidance on how to unlock unique value and navigate the challenges of the sector.

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