STRONG M&A MARKET FOR FACILITIES SERVICES

GREENWICH CAPITAL GROUP

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INTRODUCTION

Facilities Services companies are in high demand for M&A, as this market segment continues to be one of the most active in the Business Services sector. More than a thousand transactions were completed since early 2021 with capabilities of the selling companies ranging from janitorial services to a wide variety of interior and exterior building maintenance solutions. Private equity investors have been among the most active acquirers. They are aggressively seeking platform investments (i.e. their first investment into a particular vertical within the facilities services segment) and are paying attractive valuations for businesses that possess the attributes they require. Valuations are typically determined by the buyer applying a multiple to the seller's EBITDA (Earnings before Interest, Taxes, Depreciation, and Amortization.)

Businesses of larger size and scale have been and will continue to be the focus for private equity platform investments. However, the increasing competition for buyers of larger and more established businesses has caused some private equity firms to come down to the lower end of the market and acquire smaller companies than they typically would, in order to more efficiently establish their platform investment. In other words, buy in at a lower valuation multiple. Typically, smaller businesses sell for lower multiples than similar companies of larger size and scale, and as a result, some private equity investors believe they can buy an attractive smaller company for a lower valuation. While larger companies are expected to continue attracting a broader universe of acquirers at higher multiples, the increasing competition for smaller companies that can demonstrate scalability is causing their multiples to trend upward as well.

Add-on Acquisitions are in High Demand Also

Regardless of the size, private equity firms with an established platform investment are aggressively pursuing add-on acquisitions as well. For many, this has become the primary source of increasing the market share of their platform and expanding capabilities, as acquisitions are often outweighing the attention placed on more traditional organic growth strategies. Bolt-on transactions like this are typically done so at lower valuation multiples than new platform investments for many reasons. Primarily the platform company is more critical to the private equity investor, and it is more difficult to find the right company and management team that fit their rigorous investment criteria to support entry into a brand-new market segment and investment thesis.

Because they are a primary source of growth for many of the active private equity-backed platforms, the demand for add-on acquisitions is high. As such, GCG has been observing an upward trend in the valuation multiples for high-quality targets that are strategic to the platform company.

Across most areas of the facilities services segment, investors are competing aggressively to secure add-on acquisitions, as executing a successful strategy of acquiring and integrating bolt-on businesses helps to enable an outsized return potential when exiting their platform investment. In fact, it wasn't that long ago that investment strategies were centered primarily around tucking in bolt-on acquisitions at lower multiples than what was paid for the platform deal and capturing the arbitrage opportunity when the exit of the platform occurs at a higher multiple. While that is still part of the comprehensive strategy, there has been a shift over the past few years in investors being more focused on proving their platform company can grow its EBITDA quickly over shorter periods of time through the execution of a robust acquisition program. Doing so normally expands the multiple of their platform investment that can be demanded when they exit, which in turn helps them justify paying higher multiples for strong add-on companies, versus solely looking for the arbitrage opportunities.

Businesses that are of the size and scale to be a platform investment, especially ones with a management team capable of executing add-on acquisitions, are demanding attractive valuations right now. However, the aggressive pursuit for high-quality add-on targets is also making it attractive for sellers who might be a better fit to transact with an already established platform company. In an add-on scenario, a seller can not only get the benefits of transacting at an attractive value with a well-funded strategic partner, but he or she may also have the opportunity to reinvest a portion of his or her proceeds into the larger platform company that is acquiring their business. Normally equity participation is an opportunity a seller has when recapitalizing the business with a private equity partner and becoming the platform company. However, to attract high-quality add-on candidates and greater alignment with the leaders of those businesses that will continue driving growth, sellers of add-on companies are seeing more opportunities to reinvest some of their proceeds into the larger platform business, which can lead to tremendous upside in the overall value they can achieve when the private equity investor exits their platform investment, normally within two to five years or so.

WHY ARE FACILITIES SERVICES COMPANIES IN SUCH HIGH DEMAND?

Investors are attracted to the recurring demand element inherent in many of the services provided, along with the non-discretionary spending that is required for adequate facility maintenance. While facility maintenance was once a largely "in-sourced cost center function", it has rapidly transitioned into a core business practice that is outsourced and involves careful selection of third-party providers. Because many of the needs are critical to businesses operating effectively without disruption, there is often a greater importance placed on quality and fast turnaround, over cost, when selecting providers. Investors like these dynamics.

Annual spending throughout the facilities services market is expected to reach more than $1.6 trillion globally over the next 5 years (according to Mordor Intelligence), and despite becoming an increasingly outsourced, strategic business practice, the market remains highly fragmented. Local, regional, and national customers are served predominantly by a universe of thousands of local/regional players or even smaller "mom-and-pop" type operators. At the same time, customers are trying to strategically reduce the number of vendors they are dealing with by shifting towards providers that have more capabilities and the capacity to service more of their locations. As such, key players across the market continue to transform their business models to expand capabilities, increase labor capacity, broaden geographic coverage, and strengthen technological infrastructures. Because of the time, effort, and difficulty in penetrating customers with thousands of competing service providers operating throughout the country, M&A has been the primary means for participants of all sizes across the sector to accelerate these efforts.

PRIMARY CATEGORIES OF FACILITIES SERVICES

There is a wide range of capabilities that exist across the spectrum of facilities services providers. Some are focused on the systems and critical infrastructure of buildings while others are geared towards aesthetics, cleanliness, security, and managed solutions. Below are examples of the various capabilities that exist across the categories of facilities services that GCG tracks. There are others that exist as well and it is likely that additional capabilities may be developed in the future.

Cleanliness	Aesthetics	Fire/Life Safety
• Janitorial • Cleaning • Restoration • Pest Control	• Landscaping • Vegetation Management • Tree Care	• Fire/Security Alarms • Fire Suppression/Sprinkler Systems • Video Surveillance • Access Control Systems

Physical Systems & Critical Infrastructure	Other Managed Solutions
• HVAC • Plumbing • Water Heater • Filtration Equipment • Wifi/Broadband • Power Systems • Generators • Elevators • Escalators • Material Handling Systems	• Security Guards • Parking Lot Monitoring • Mobile Patrol • Front Desk/Concierge • Laundry/Linen Rental • Uniform Rental • Hygiene Supply Management • Waste & Site Services

The correlation to operators functioning effectively throughout their facilities varies greatly across the categories of services, similarly to the level of skill required to perform the service. Some services are required on a “recurring” basis (i.e. daily, weekly, monthly) while others are less predictable but still anticipated on a “re-occurring” basis. Preventative maintenance and reactive emergency services are important offerings that also reoccur, albeit less frequently.

Differentiation among providers can be meaningful as well. For example, some providers specialize in a certain industry or capability and are recognized as “pure-play” market leaders among the niche they service, whereas others are more generalized amongst a larger group of peers with less uniqueness. Sufficient access to labor and capacity are also key drivers for business operators and facility managers who have to rely on an exclusive or sole source provider, versus maintaining relationships with more than one qualified vendor for a particular need.

These factors, and others, lead to variability across the level of predictability and stickiness of the revenue streams for providers. They also have an impact on pricing and the resulting profitability margins that can be achieved. The ongoing sustainability of existing profit margins is also heavily influenced by the level of dependency customers have on their providers, along with the availability of others that provide similar quality, pricing, and capacity. These fundamentals are key drivers of the level of M&A interest from acquirers and investors, along with the valuation multiples they are willing to pay for a particular business.

It is expected that local, regional, and national facilities services providers will continue building out their platforms at a rapid pace.

IN CONCLUSION

It is expected that local, regional, and national facilities services providers will continue building out their platforms at a rapid pace. Customers require technological advancements that enable greater transparency and superior service. They also desire to reduce the number of vendors they have to manage by seeking “one-stop” partners that are investing in additional capabilities and labor capacity, while expanding their geographic reach to service more of their locations.

At the same time, the facilities services market is highly fragmented with thousands of providers across the country. Many of these companies are local or “mom-and-pop” type operators that have long-term customer relationships. While these smaller companies tend to be concentrated and lack the infrastructure required to expand, they still may have good relationships. This makes it difficult for larger regional and national players to expand their market share further by organically growing into new markets or to penetrate customers deeper by internally developing new capabilities and displacing these types of operators. With a high degree of competition for labor, it is also challenging for providers of all sizes to recruit and retain talented people at the pace required to pursue all of their growth opportunities that exist.

Because of these dynamics and other considerations discussed throughout this publication, companies that desire to grow and increase their relevance to customers are likely to adopt M&A as a key component of their long-term strategic planning. As such, GCG expects the current high level of demand for M&A across the facilities services segment will continue and strong valuations for both new platform and add-on transactions should sustain, making it attractive for owners that wish to explore a sale of their company.

Relevant Transaction

PRONTO
PROFESSIONAL FACILITY SERVICES

has been acquired by

TECH24

a portfolio company of

HCI EQUITY PARTNERS

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GREENWICH CAPITAL GROUP

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