

Facilities & Industrial Services: 2022 Market Perspectives

LONG-TERM TRENDS DRIVING GROWTH AND UNDERPINNING FACILITIES AND INDUSTRIAL SERVICES M&A

Investor interest in facilities and industrial services remains high, given the numerous attractive tailwinds that underpin the sector’s resiliency and growth potential. The sector is evolving, and subsectors within the broader facilities and industrial services market are poised to benefit. Specifically, the facilities and industrial services sector has been at the forefront of a secular outsourcing trend as companies turn to alternatives for non-core functions. Despite this ongoing shift towards outsourcing, many subsectors remain highly fragmented, with local, regional and national customers predominantly served by a highly fragmented universe of “mom and pops.” As business models in the sector continue transforming to meet shifting customer needs, strategic consolidators and private equity investors have accelerated their investment in the space.

Mergers and acquisitions (M&A) momentum is expected to continue in the facilities and industrial services sector due to highly attractive business characteristics, growth opportunities and pandemic / recession resiliency which is fueling investor interest and strong valuations for high-quality platforms. This report outlines key trends and themes driving ongoing investor interest.

KEY TRENDS

Investor Focus on Recurring Revenues	Premium value is placed on recurring revenue streams, mainly those that are maintenance and repair in nature
Increased Demand for Outsourced Services	Companies are increasingly utilizing outsourced service providers for all non-core functions
Diversification of Services Offering	Service providers aim to be the one-stop-shop for all services within their respective industries
Increased Regulatory Pressure	Regulatory pressures fuel demand for increased retrofit, preventative maintenance and repair revenues
Fragmented Market	Fragmented industries drive M&A activity as companies aim to be the consolidator of choice

SUBSECTORS

- Elevator Services
- Exterior Building Services
- Fire and Life Safety
- Foodservice
- HVAC/R
- Industrial Services
- Janitorial, Cleaning and Restoration
- Landscaping
- Laundry and Linen
- Mechanical, Electrical and Plumbing
- Pest Control
- Security and Safety
- Smart Building and Building Efficiency



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Elevator

- The elevator installation and service market generates revenue from the repair and maintenance of existing elevator systems and the installation of new systems
- The competitive landscape is highly fragmented, with few providers of scale offering an independent, national service alternative to the big four elevator manufacturers: Otis, Thyssenkrupp, Kone and Schindler
- Elevator maintenance has attracted interest from financial sponsors due to monthly maintenance requirements (e.g., lubing and greasing cables) and regulatory / insurance mandates

Attractive Sector Attributes

- 1 | Mandated and preventative maintenance requirements create highly recurring revenue streams
- 2 | Rising urbanization and government initiatives continue to drive market growth

Exterior Building Services

- Exterior building services feature a plethora of facility services, including window and façade cleaning, power washing and paving, amongst others
- The segment comprises localized, fragmented trade categories, which makes it a hypercompetitive segment for M&A activity as there is an urgent need for consolidation
- The segment enjoys recurring, recession-resistant demand with opportunities for margin enhancement via operational improvements and technology enablement; this will encourage innovative platforms to consolidate self-delivery, deploy asset-light programs, or form franchise brands

Attractive Sector Attributes

- 1 | Few facility operators have full in-house capabilities which creates a high need for outsourced solutions
- 2 | Trends in urbanization are creating an increased need for integrated exterior building services platforms within both commercial and multi-family residential

Fire and Life Safety

- Amid mounting regulatory oversight and compliance expectations in the fire and life safety services sector, investors are pursuing roll-up strategies
- The fragmented sector's recession resilience and recurring revenue streams make it increasingly attractive among buyers, driving record levels of consolidation in recent years
- National Fire Prevention Association has mandated more than 300 consensus codes to minimize the effects of fire and other risks, such as requiring the installation of fire protection systems in new commercial installation projects
- Smart technologies are being increasingly implemented in fire protection systems to proactively control and reduce the impact of fire accidents through real-time remote access and centralized control mechanisms, while the rise in U.S. housing starts and strict government regulation for the installation of fire protection systems will foster market growth

Attractive Sector Attributes

- 1 | Local, state and federal mandates create nondiscretionary, non-deferrable demand for fire equipment inspections
- 2 | Stringent regulatory hurdles and license requirements create a high barrier to entry in the industry
- 3 | As consolidation occurs, portfolio companies will offer expanded capabilities across broader geographic footprints

Foodservice

- Strong growth within the foodservice management segment is underpinned by increased outsourcing of break room refreshment, vending services, recognition of food / snacks as an employee benefit, continued shift toward away-from-home food consumption, strong desire for healthy food options and improved vending technologies
- The adoption of micro markets and offshore hospitality management among refreshment services providers has driven growth in the market
- An increase in tuck-in acquisitions in existing geographies and platform acquisitions in new geographies is expected to add value to the foodservice market
- Regardless of macroeconomic trends, outsourced equipment repair services are critical to ongoing foodservice operations and are not tied to restaurant foot traffic

Attractive Sector Attributes

- 1 | Rise in demand for multi-functional space and time-saving equipment
- 2 | Adoption of improved technology at the point-of-sale for cashless vending and telemetry is enhancing consumer convenience

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HVAC / Refrigeration

- The approximately \$22 billion outsourced refrigeration and heating, ventilation and air conditioning (HVAC) services market is comprised of outsourced HVAC services (approximately \$19 billion) and outsourced commercial refrigeration services (approximately \$3 billion) and has grown approximately 3% to 4% annually over the last five years
- Through tuck-in acquisitions, HVAC / refrigeration players can grow their services in new or existing geographies and expand their product portfolio by offering complementary services
- A fragmented landscape dominated by local providers; it is one of the most hyperactive categories of facility services M&A
- The lack of dependable, independent players with scale in the HVAC / refrigeration market allows established service providers to drive price and volume increases, leading to growth
- Government incentives related to retrofitting in existing buildings are expected to drive the demand for HVAC installations and maintenance

Attractive Sector Attributes

- 1 | Fragmented market with opportunity for tuck-in acquisitions creates opportunities for operators to expand service offerings
- 2 | Maintenance and repair services are highly recurring in nature and attract high multiples
- 3 | HVAC and refrigeration services are recession resistant given their “mission-critical” nature

Industrial Services

- Industrial services include engineering and consulting, installation and commissioning, operational improvement and maintenance services
- Growth in the industrial service market is fueled by ongoing service contracts and agreements, increasing rates of product development and expansion
- Increasing product and system complexity has increased the demand for specialized and outsourced labor as companies seek to eliminate product and process downtime
- Industry operators are undergoing rapid digitization as customers increasingly expect personalized service, convenience and on-demand maintenance and repair services
- Companies have realized the long-term cost savings associated with preventative maintenance, increasing recurring maintenance and repair revenues for industry operators

Attractive Sector Attributes

- 1 | Growing rates of technology development increase the need and pace of maintenance and repair services
- 2 | Machine and product complexity has increased the need for preventative maintenance, creating higher recurring revenues for operators

Janitorial, Cleaning and Restoration

- Janitorial, cleaning and restoration services clean the interiors of buildings and include contract cleaning services
- The effects of COVID-19 have varied within the facilities services sector, depending on the service type and end-markets served – there was a fundamental shift in this subsector as COVID-19 raised awareness and the criticality of cleaning services in business
 - The post-pandemic world is expected to see commercial cleaning shift from simply a cost center to a strategic driver of health, safety and well-being
- Amidst renewed focus on office and commercial space hygiene, the industry is seeing increasing consolidation and platform-building activities
- Intensified compliance and regulatory requirements in the commercial cleaning space are likely to boost the demand for these services, with regular cleaning and disinfection becoming the new regulatory standard

Attractive Sector Attributes

- 1 | Enhanced focus on hygiene and cleanliness due to COVID-19 has increased the number of services provided and bolstered revenue
- 2 | In response to COVID-19, facilities have focused on preventative cleaning services, enhancing recurring revenue

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Landscaping

- The U.S. landscaping services market has a total addressable market of \$115 billion
- Landscaping services is highly fragmented and in localized markets that services all building services beyond the “four walls,” such as routine mowing, tree care, irrigation and fertilization services, which are mostly outsourced and contracted by facilities
- There is an urgent need for consolidation in this market so that providers enjoy the benefits of centralizing procurement, increased territories and route density and can offer value-added services with scale; as a result, the market is seeing a bevy of M&A transactions with financial sponsors
- Larger clients, such as real estate investment trusts, integrated commercial real estate firms, housing associations and leading global retailers, are clear in their desire to engage large-scale, value-creating service partners
- A high portion of industry revenues come from ongoing maintenance and enhancements of existing landscaping plots; however, increased spending in non-residential construction has driven the growth of new projects in recent years

Attractive Sector Attributes

- 1 | A high percentage of revenues come from ongoing maintenance and repair services
- 2 | The fragmented and localized market remains highly attractive for M&A with actionable growth opportunities
- 3 | Attractive and well-maintained exterior premises are a crucial part of customer service and overall brand image for retailers, corporations and real estate management companies alike

Laundry and Linen

- The laundry and linen market, valued at approximately \$16 billion, is one of the earliest adopters of the outsourced service business model with every market, especially healthcare
 - The fastest growing segment is linen launderers, propelled by continued gains in the healthcare and hospitality industry – the laundry and linen subsector is comprised of the “big three” companies (Cintas, Aramark and UniFirst), which control more than 50% of the market share, and nearly 3,000 local and regional businesses, which constitute the rest of the share
 - Uniform launderers are expected to become the largest segment in 2022 due to continued gains in retail and foodservice sales
- Clean linens are critical to companies’ operations; customers rely on outsourced service providers for exceptional quality / hygiene and reliable delivery
- Companies are reinvesting in technologies to serve client pain points, such as tracking asset shrinkage in pick-up / clean-up / drop-off process and on-site services

Attractive Sector Attributes

- 1 | Route-based business model underpinned by daily / weekly service
- 2 | Fragmented market with high opportunities for regional consolidation and growing market share
- 3 | Predictable cash flows supported by long-term contracts and high switching costs

Mechanical, Electrical and Plumbing

- Mechanical, electrical and plumbing (MEP) providers assist in the planning, design and maintenance of buildings and encompass services such as plumbing system design and maintenance, electrical power circulation and machine monitoring and repair
- Consolidation strategies, benefiting from the fragmented market landscape, drive not only platform scale but also utilization and margin of technicians and equipment
- Through a buy-and-build strategy, investors have a tangible opportunity to drive substantial cross-selling synergies by adding complementary services that are delivered to a common customer base
- The Federal Infrastructure Investment and Jobs Act is driving growth within MEP services, as the U.S. government will deploy \$1.2 trillion in infrastructure spending

Attractive Sector Attributes

- 1 | Federal legislation is injecting billions of dollars into the MEP industry
- 2 | The highly specialized nature of industry services creates high barriers of entry for non-established companies
- 3 | Fragmented market with thousands of “mom and pop” service providers

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Pest Control

- Pest control companies provide extermination services for mosquitoes, rodents, termites and other insects and pests
- Industry operators continued to exhibit growth through the COVID-19 pandemic due to the resiliency of the residential housing market, the recurring nature of services provided and increased spending on home improvements
- Increased regulation and legislation along with increasing hygiene standards have led to fewer customers seeking “do-it-yourself” solutions and instead seeking qualified pest control providers; as the industry becomes more regulated it will put pressure on smaller local and regional players to maintain compliance
- Increased consumer knowledge and fear of pesticides has dramatically increased the rate at which industry operators have adopted eco-friendly solutions

Attractive Sector Attributes

- 1 | Route-based business model underpinned by ongoing service requirements
- 2 | Warm winters, wildfires and floods have led to increasing pest populations and the need for professional pest control solutions
- 3 | Continued trends towards urbanization are increasing the need for pest control services as pests spread more easily in densely located areas

Security and Safety

- This sector covers a various array of service and equipment categories, including entry systems and alarms, video surveillance and access control monitoring
- A fragmented market offers a tremendous opportunity to gain meaningful scale across perimeter service adjacencies by aggressively pursuing M&A
- Rise in illegal activities, breaches of security systems, planned crimes and terrorism activities have forced government entities to introduce strict security measures and regulations; further, businesses are employing innovative technologies like internet protocol-based security cameras for remote access, motion sensors and wireless technology to protect crucial information, thereby driving the security and safety market

Attractive Sector Attributes

- 1 | Increased rates of lawlessness, particularly in urban areas, has created a renewed sense of importance for reliable security services
- 2 | Security and safety services are increasingly seen as a mission-critical service, essential to core operations
- 3 | Fragmented market with an opportunity to enter service adjacencies

Smart Building and Building Efficiency

- Smart buildings use sophisticated control systems to help lower operational costs in tenant management, security and energy efficiency, while the building efficiency market focuses on electrification and conservation in residential and commercial buildings
- Growing renewable energy standards and increasing levels of corporate and residential demand for energy efficiency will drive activity within the sector
- As buildings become increasingly “smart” and tech-enabled, leading platforms are branching into tangential categories such as fire and life safety, building automation, mechanical controls and cybersecurity
- Approximately 75% of surveyed U.S. facility managers say COVID-19 has caused them to rethink facility operations permanently; 70% are more willing to invest in smart building solutions to drive efficiency and support sustainability efforts

Attractive Sector Attributes

- 1 | Technology-forward mentality, energy efficiency, smart systems, Internet of Things and automation function as valuation drivers
- 2 | COVID-19 has placed a spotlight on the need to invest in smart building solutions to optimize building operations with the ability to scale based on building utilization

CONCLUSION

There is ample opportunity in the facilities and industrial services sector to consolidate a fragmented market, typically comprised of regional or local businesses, and offer expanded capabilities across broader geographic footprints to a wider customer base. Additionally, the highly resilient, non-discretionary demand drivers that underpin the sector provide long-term revenue and earnings visibility, resiliency and stability.

Deal flow in the space has remained strong, and Lincoln International expects high levels of consolidation to continue as private equity firms and corporate players pursue roll-up strategies in resilient sectors.

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