



INDUSTRY OUTLOOK

HVAC Industry (Canada)

Q4 2021



Summary

The State of HVAC

Baker Tilly Corporate Finance believes that the HVAC industry has performed strongly in Q4 2021. The fundamentals remain strong, with growing investment in non-residential construction, despite a decrease in the number of housing starts and investment in construction, which is due to seasonality. Inflation rates through the pandemic were high with fiscal policies that injected the economy with cash. As a result, interest rates are on the rise following the global recovery.

There is strong demand for HVAC M&A, as evidenced by the many deals that were closed. In particular, Right Time Heating and Air Conditioning, owned by Gryphon Investors, has been consolidating fast with two transactions closed in the past quarter, and five closed earlier in the year. This is consistent with the strong M&A trend that occurred in 2021 fuelled by the record setting amount of dry powder deployed in the market.

In the public markets both HVAC manufacturers and installers have had revenues recoup from the downturn caused by the pandemic. EV/EBITDA multiples have also rebounded from the decrease that happened at the start of the pandemic. At the end of 2021, public HVAC manufacturing companies were trading with an average EV/EBITDA multiple up 23%, and public HVAC service providing companies were trading with an average EV/EBITDA multiple down 10%.

Overall, the market has a significant amount of dry powder that is waiting to be deployed. However, the future availability of that money is not certain as interest rates may influence where investors want to store and grow their wealth. The HVAC industry is expected to continue performing strongly because of government initiatives that support growth based on their goal of tackling climate change.

Select M&A transactions

Sell-side Engagement Highlights



Gordon Latham Ltd.

Founded in 1927, **Gordon Latham Ltd. (Latham's)** was a locally owned mechanical contracting company specializing in service, maintenance and retrofit work throughout the Lower Mainland. With 57 trucks on the road and 90 staff, Latham's was one of the oldest and largest mechanical services providers in B.C. Its client base includes multi-unit residential apartment buildings, industrial plants, institutional facilities and commercial office complexes.

- After running Latham's for 50 years, its principal considered: playing golf for the rest of his life, and transitioning the company to a well-resourced purchaser that would care for Latham's stakeholders
- Roster of 90+ potential purchasers was developed, comprised of strategic acquirers, private equity groups and family offices → 36 reviewed the CIM and received LOIs from 5 parties
- 100% of Latham's was successfully sold in an all-cash transaction to Ainsworth, a leading, integrated, multi-trade company providing services including HVAC, mechanical, *electrical*, data cabling and industrial automation services for institutional, commercial and industrial clients *across* Canada
- Ainsworth is a subsidiary of GDI Integrated Facility Services (TSX: GDI), a publicly traded company from Montreal

Baker Tilly Canada Corporate Finance Inc. acted as exclusive financial advisor to Latham's in structuring and negotiating this transaction.



GAZELLE
CAPITAL

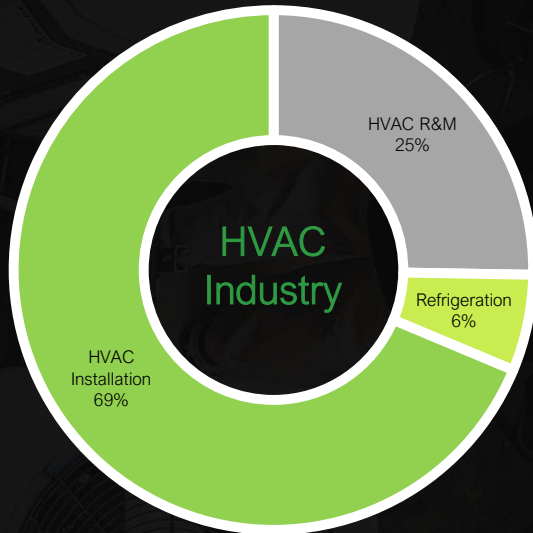
Pacific West Mechanical Ltd.

Pacific West Mechanical Ltd. (PacWest) was founded in 2005 to capitalize on market demand for focused plumbing/HVAC service and maintenance services for multi-family residential buildings in BC. Today, with 26 trucks on the road and over 35 non-union staff, PacWest, is one of the largest plumbing/HVAC service providers in the multi-family sector in BC. Clients include many of the largest and most established property management firms in BC with PacWest servicing marquis buildings including Arc, One Pacific, Park Place Towers, Three Harbour Green and West Pender Place.

- After running PacWest for over 17 years, PacWest's founders, Clare and Nick were looking to take some chips off the table and bring on partners who could assist them with pursuing the significant growth opportunities available to the business.
- A well-researched roster of 130 potential acquirers was developed consisting of strategic purchasers, search funds and private equity groups across North America. Of these, 50 reviewed the Confidential Information Memorandum (CIM), which ultimately led to a high number of offers being submitted. → The successful bidder was Gazelle Capital - a search fund headed by two experienced businesspeople and backed by investors in Toronto and across the United States.
- A significant stake in Pacific West Mechanical Ltd. was sold to Gazelle at a favourable valuation with good terms.
- Clare and Nick will continue to work full time in the business and will be joined by Jody and Brent from Gazelle to further accelerate the growth of PacWest.

Baker Tilly Canada Corporate Finance Inc. acted as exclusive financial advisor to Pacific West Mechanical in structuring and negotiating this transaction.

Overview



Key Stats Quarter over Quarter Change

Metric	Increase/decrease (%)	
Investment in non-residential construction	↑	3.9%
Investment in commercial construction	↑	5.7%
Investment in residential construction	↓	10.0%
Overall investment in construction	↓	6.7%
Housing starts	↓	0.2%
Wages and salaries	↑	3.6%
Household spending on durable goods	↑	1.3%

HVAC industry – Q4 2021 vs Q3 2021

- The **Heating and Air-Conditioning Contractors industry** in Canada is highly dependent on construction activity across Canada, as majority of the revenue (approx. 69%) is generated from HVAC installations in new residential and non-residential buildings¹.
- **Residential building construction costs** increased 3.8% in the fourth quarter of 2021, following a similar rise in the third quarter. Non-residential building construction costs were up 2.7% in the fourth quarter, decelerating slightly from the previous quarter².
- **Investment in non-residential construction** was up 3.9% to \$15.1 billion. The gains were led by the commercial component (+5.7%), which represents its fourth consecutive quarterly increase².
- **Investment in residential construction** was down 10% compared with the third quarter. The loss was led by the single dwelling building component (-12.8%)².
- The number of **housings starts** has decreased slightly by 0.2% relative to the third quarter. Notably, there is a reduction in the number of single-detached homes by 13%, and an increase in multi-family and apartments by 6% and 7%, respectively.

Market growth

Industry Trends

Government energy-efficient incentives are expected to benefit HVAC contractors as energy-efficiency ratings will become more essential.

Industry profitability and performance

	Gross Margin *		EBITDA Margin *	
	Manufac.	Servicing	Manufac.	Servicing
High	35%	49%	19%	23%
Low	18%	10%	8%	4%
Mean	28%	23%	13%	10%
Median	28%	18%	14%	7%

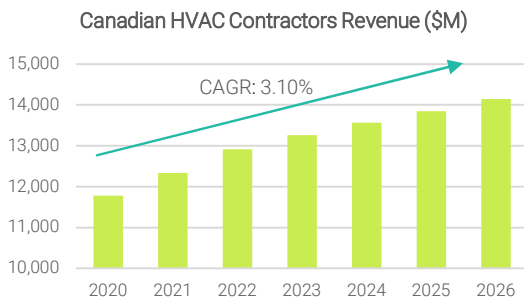
Source: Capital IQ

- Non-residential construction is expected to grow as the economy recovers from the pandemic. The growth is expected to be modest as the Bank of Canada (BOC) is projected to raise its baseline interest rate to stave off inflation.

Industry employment

Employment in HVAC is expected to increase from 59,400 to 68,964 from 2020 to 2026, and wages are expected to increase from \$4.1B to \$4.8M in the same time period⁴.

Forecast



Source: IBISWorld

Demand for HVAC services is expected to trend upward, following depressed economic conditions caused by the pandemic:

- Government energy-efficiency initiatives³ are expected to increase demand for more efficient systems. Additionally, the rise in price of electric power increases the cost savings from efficient HVAC systems for households and businesses.
- Residential renovation spending is expected to rise. Additionally, if housing prices remain high, consumers may opt to renovate their existing homes at a higher rate versus purchasing a more expensive home.

Interest rates

At the start of the COVID-19 pandemic all major central banks and reserves had dropped their interest rates. Since then, the Federal Reserve has increased their interest rate from 0.25% to 0.5%⁵, and Bank of Canada has increased their interest rate from 0.25% to 1.0% in April 2022⁶.

Legal changes

The Government of Canada aims to improve energy efficiency standards to support climate change goals. Through alignment with United States agency ENERGY STAR, Natural Resources Canada aims to:

- Increase the minimum energy performance standards (MEPS) of major household appliances to the energy efficiency performance levels required to achieve ENERGY STAR certification. ENERGY STAR is a global energy efficiency performance program, led by the US Environmental Protection Agency. In a 2019 letter, the Minister of Natural Resources included direction to “make ENERGY STAR certification mandatory for all new home appliances”⁷.

Increased government pressure will increase demand for more energy-efficient systems contributing to the growing trend toward replacements.

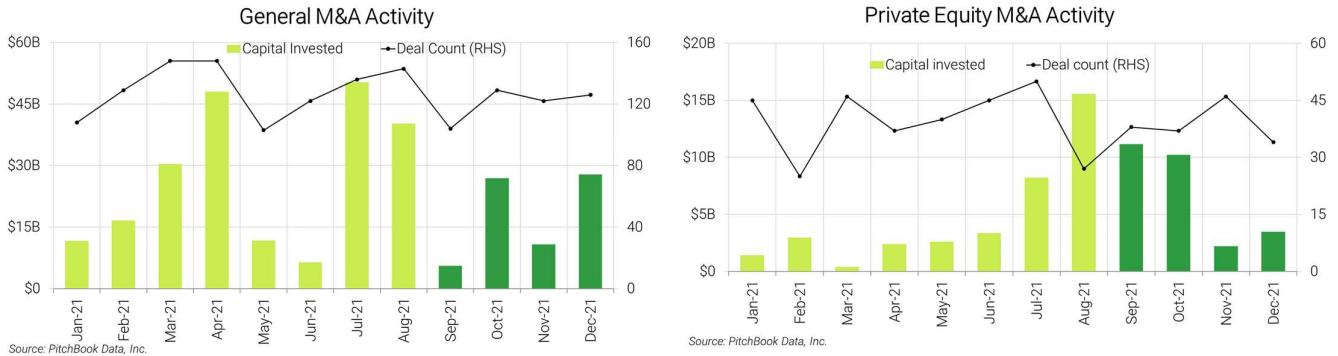
*Figures based off BT Indexes

Industry valuations

Mergers and Acquisitions (M&A)

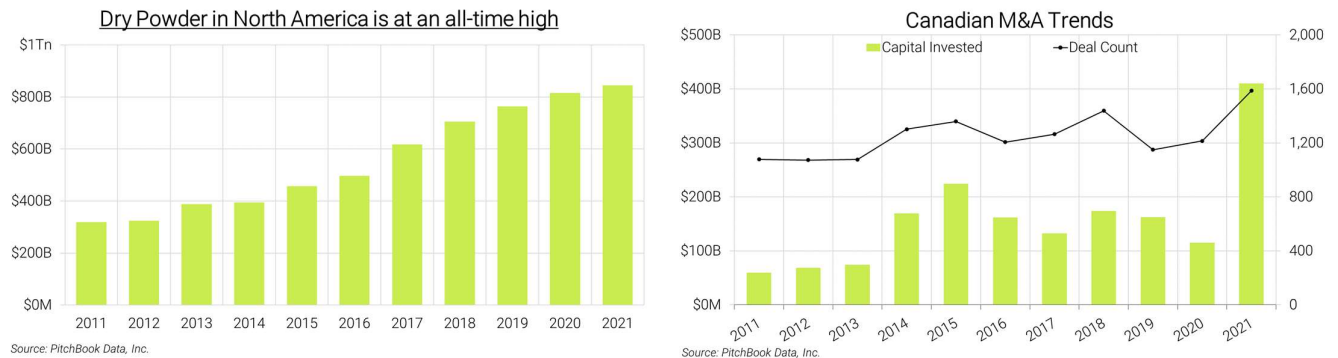
2021 saw the highest deal count and capital invested within Canada, making it the best year for Canadian deals in the last ten years.

Recent M&A Activity



- Q4 2021 saw 376 company-to-company M&A transactions close in Canada, representing C\$65.5B of capital invested in transactions (left).
- Along with the above transactions, private equity (PE) transactions totalled 117 in Q4, representing C\$15.9B of capital invested (right).

Buying Trend is Expected to Continue



- **Dry powder** refers to the amount of committed, but unallocated capital a firm has on hand. In other words, it's an unspent cash reserve that is waiting to be invested. With more cash on hand than ever before, PE firms are grappling with how to deploy it and will likely look to private market investment to fuel growth for portfolio companies.
- For these reasons we expect Canadian M&A to continue its strong performance into the rest of 2022.

Recent M&A transactions

Select Transactions

Notable HVAC transactions in Canada over the past two years include:

Companies	Deal Date	Deal Type	Investors
	21-Feb-2022	M&A	
 Precision Refrigeration • Service • Install • Maintenance	25-Jan-2022	M&A	
	21-Jan-2022	M&A	
	20-Jan-2022	M&A	
	18-Jan-2022	M&A	
	14-Dec-2021	Buyout/LBO	
 HEATING • COOLING • PLUMBING • ELECTRICAL	09-Dec-2021	Buyout/LBO	
 HOME HEATING & COOLING	18-Oct-2021	Buyout/LBO	
	29-Sep-2021	Buyout/LBO	
	15-Sep-2021	M&A	
	10-Aug-2021	Buyout/LBO	
 Since 1981	01-Aug-2021	Buyout/LBO	
 Commercial • Residential • Process • Mechanical Contractors	01-Aug-2021	M&A	Metro Group of Companies
 THE HEATING AND COOLING PROFESSIONALS WHO CARE	16-Jul-2021	Buyout/LBO	
	22-Jun-2021	Buyout/LBO	
 Heating • Cooling • Air Quality • Repairs	03-Jun-2021	Buyout/LBO	
	03-Jun-2021	Buyout/LBO	
	03-Jun-2021	Buyout/LBO	
 BÂTIR MAINTENIR GRANDIR	01-Jun-2021	M&A	
	01-Jun-2021	M&A	O'Dell Associates
	12-May-2021	M&A	
	05-Apr-2021	Buyout/LBO	
 AtlasCare	10-Mar-2021	Buyout/LBO	

Pitchbook Definition:

M&A: A company acquires at least a controlling position in another company.

Buyout/LBO: A private equity firm acquires at least a controlling position in another company.

Buyer Profile

Q&A with David Hinchey

(Executive VP of Corporate Development at GDI Integrated Facility Services Inc.)

1. How do you decide which companies to pursue and which ones to pass on?

There are a number of things that we look for to determine if an acquisition opportunity is a good strategic fit – geographic location and coverage, size of the company, depth and strength of the management team, end markets serviced, financial health and margin profile, etc. While each of these has a different weight in the decision matrix, and strength in one can offset weakness in another, the single most important criteria for us is a good cultural fit. Under our acquisition strategy, we view companies that join us through acquisition as business partners, and if there isn't a good cultural fit and shared values the partnership won't work. So, there isn't one single criteria that would cause us to pass, but if there is not a good cultural fit and common values there is a low probability that we would have an interest.

2. What are the primary levers in determining your offer price?

a. What financial factors influence the value of a business?

Assuming businesses in the same industry with similar business models, the main factor that influences valuation is the size of a business – larger companies garner larger purchase multiples. Other financial factors would be gross margin profile, with higher than industry average margin companies that have sustainable margins being more attractive than lower than industry average margin companies. We also do a lot of work on benchmarking a company's COGS and SG&A line items to industry benchmarks to make sure they are operating at sustainable levels.

b. What non-financial factors influence the value of a business?

There are a number of these: companies that are well diversified by client, end markets serviced and geography tend to have better valuation profiles; strength of the management team; length of time key people plan to remain post-closing; age of the management team; quality of the client base; attractiveness of the end markets serviced; reputation of the company; quality of financial information; there are a large number of factors that go into the determination of the ultimate purchase multiple used. A higher level of comfort on these factors means a lower risk for a buyer and translates into a higher purchase multiple.

3. What are some of the trends you are noticing in the industry?

As a result of COVID we have seen a major focus across the HVAC/building systems industry on indoor air quality, and technologies or processes such as UV purification, bipolar ionization, enhanced filtration and dilution ventilation to obtain an optimum level of air quality in buildings. We have also seen an emerging long term trend towards smart building technologies, which at the core are technologies that extract data from a building (system functionality, energy usage, people monitoring, asset tracking, commodity usage, etc.) and perform analytics with that data to optimize energy usage, increase efficiencies, reduce carbon footprint and enhance occupant experience. The buildings of the future will have a very different technology profile than those of today.

4. What are some macroeconomic factors that influence your decision to buy or sell? (Ex. interest rates).

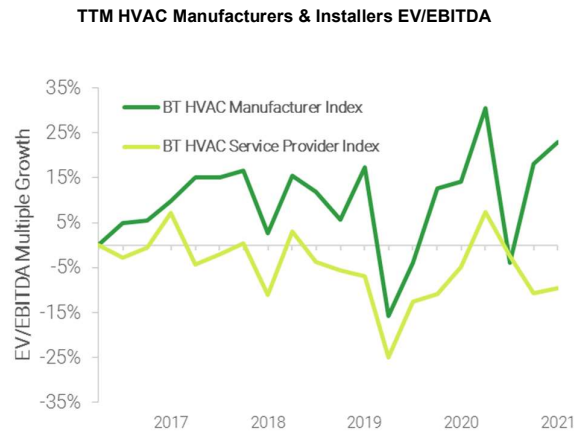
Nothing really. We have grown by using our balance sheet to fund acquisitions and we repay those borrowings over time with internally generated cash flow. We do not allow ourselves to become over levered and operate with a healthy balance sheet, which enables us to weather any changes in macroeconomic factors and retain the ability to make an acquisition when the right opportunity presents itself.

Key findings

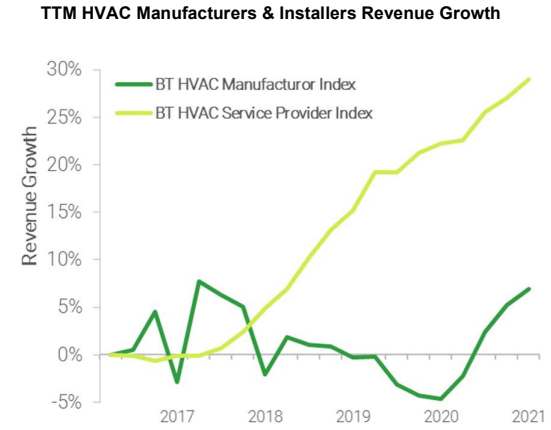
Industry Snapshot

Both the publicly traded HVAC Manufacturers and Service Providers had a decrease in EBITDA multiple due to COVID-19 but have since recovered. HVAC Service Providers had consistent growth in revenue, even throughout the pandemic, where HVAC Manufacturers saw a dip related to COVID-19.

Industry valuations



Source: Capital IQ



Source: Capital IQ

In the Public Sector:

- **BT HVAC Service Provider index** is trading with a relatively stable Enterprise Value to EBITDA multiple, having a spread of 32% between the highest and lowest multiples.
- **BT HVAC Manufacturer index** is trading with a more variable Enterprise Value to EBITDA multiple, having a spread of 46% between the highest and lowest multiples.

In the Private Sector:

- **Aggreko PLC**, which is a provider of cooling and heating rental equipment, was valued at an **Enterprise Value of \$3.625B** at an **EBITDA of \$421M**.
- This gives a **multiple of 8.6x** which is **lower by 20%** relative to the BT HVAC Service Provider index at the time of sale.

EBITDA multiples for publicly traded companies are consistently higher due to several factors investors equate value to like: size, liquidity, customer concentration, financial statement assurance, etc.

BT HVAC Manufacturer Index: *Aeon Inc, Carrier Global Corp, Comfort Systems USA Inc, Johnson Controls International PLC, Lennox International Inc, SPX Corporation, Trane Technologies PLC, Watsco Inc*

BT HVAC Service Provider Index: *Comfort Systems USA, CSW Industrial Inc, Dexterra Group, EMCOR Group Inc, Frontdoor Inc, GDI Integrated Facility Services Inc, Lambach Holdings Inc, Tutor Perini Corp*

BT HVAC Manufacturer and Service Provider Indexes may have operations that span beyond only HVAC manufacturing or service providing.

Testimonial

Past Client



Our experience in working with Baker Tilly exceeded our expectations. Baker Tilly's level of professionalism, superior knowledge surrounding mergers and acquisitions and tenacity to reach a favourable outcome solidified our decision that we made the right choice in selecting their firm to manage the sale of our company. Baker Tilly supported us around the clock with timely responses and ensured that the deal was always progressing forward. We can confidently say we would not hesitate to recommend their team.



- Clare Gilbert Tabako & Nick Tabako
Founders, Pacific West Mechanical Ltd.



Appendix

End Notes

Sources

1. IBISWorld
2. Statistics Canada, 2022
3. Government of Canada “Natural Resources Canada.” Canada, N. R., 2022, April 21.
4. IBISWorld “Heating & Air-Conditioning Contractors in Canada” Samuel Kanda, 2021.
5. Trading Economics “United States Fed Funds Rate” Trading Economics, 2022.
6. Bank of Canada “Policy Interest Rate” Bank of Canada, 2022.
7. Efficiency Canada “No reason for Canada to delay appliance efficiency standards” Brendan Haley, 2021.

Corporate Finance

Why Baker Tilly?

Baker Tilly is able to offer an integrated approach to all facets of the proposed transaction to provide a seamless, efficient service.







When you choose to work with a Baker Tilly firm, we value the trust you invest in us.

We reward that trust by developing great relationships, that lead to great conversations, that deliver great futures. We serve clients that span every sector and size, but we never lose sight of you. At Baker Tilly, we have the international reach and local knowledge needed to translate your ambition to new markets. Through a single, personal point of contact at your local firm, you can access technical knowledge, thought leadership and professional expertise spanning the globe.

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 Transaction Services	 Lead Advisory	 Valuation	 Tax Structuring	 Consulting
<ul style="list-style-type: none"> - Financial and Tax Due Diligence - Focused scope on issues that are most important to you 	<ul style="list-style-type: none"> - Deal strategy and origination - Negotiation and structuring advice - Preparation of Term Sheet - SPA advice - End-to-end project management 	<ul style="list-style-type: none"> - Modelling - Valuation - Purchase Price Allocation 	<ul style="list-style-type: none"> - Tax structuring planning and implementation - Tax structuring advice 	<ul style="list-style-type: none"> - Operational due diligence - Commercial due diligence - Synergy assessment - Post-acquisition integration
Ongoing transaction project management 				
<p>We are able to tailor our service offering to meet your deal requirements with services available using an integrated product approach or on a stand-alone basis, which will not impact our independence</p>				

Contact details



Mike McIsaac, CPA, CA
CEO & Managing Director
+1 (604) 750 9510
mmcisaac@bakertilly.ca



Howard Ma, CFA
Associate Director
+1 (778) 807 8560
howardma@bakertilly.ca



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