

AHR EXPO TAKEAWAYS & CURRENT M&A OUTLOOK

HVAC SECTOR UPDATE | MARCH 2023



Carter Morse & Goodrich
Investment Bankers & Since 1987

AHR EXPO 2023 TAKEAWAYS

Carter Morse & Goodrich made our annual trip to the AHR (Air-conditioning, Heating & Refrigeration) Expo in Atlanta a few weeks ago to see the latest trends in HVAC and meet with executives, thought leaders and business owners at the forefront of the industry. As one of the preeminent trade shows for the HVAC industry, the 2023 AHR Expo hosted nearly 1,800 exhibitors and 50,000 visitors over three days. For CMG, AHR is an excellent opportunity to connect with past and future family-held and founder-led businesses, talk with leaders in the industry and gain valuable insights into the challenges and opportunities facing the HVAC industry in the year ahead.

This year, we came away with five key themes currently shaping the industry:

1. **Product innovation drives the need for more training**

The HVAC industry continues driving towards a cleaner future with new regulations that became effective in January 2023. With that in mind, new product innovation has driven the need for equipment manufacturers and their trusted distributors to focus more on education and training opportunities for contractors who will ultimately install, upgrade and service these new environmentally friendly systems. Education for end market HVAC contractors has become a key differentiator and those that do it well are separating from the pack and are driving real value resulting in higher sales volume, stronger relationships with both suppliers and customers and incremental value when it comes to M&A.

2. **Combatting the supply chain “Perfect Storm”**

Global supply chains continue to feel the impact of resource, equipment and labor shortages throughout the HVAC industry. With a global supply chain refined to be both lean and efficient, the pandemic



provided a “perfect storm” of events that was defined by huge pricing shocks, dramatic shortages and much longer lead times. As a result, operators converted the well-established “just in time” sourcing model to a new “just in case” approach, where companies stockpiled inventory, leading to more volatility and instability. Our research implies that inventory levels are beginning to moderate from all-time highs in mid-2022, but that the overall supply chain may continue to be challenged well into 2023 and possibly beyond. We expect businesses that can successfully mitigate supply chain disruptions will certainly outperform their peers who are slower to react.

3. **Inflation remains elevated, but so is confidence**

Inflation and fear of recession have been two key concerns gripping the entire economy, and the HVAC industry has not been immune. Rising prices for materials and components, increases in labor costs and an uncertain supply chain have put real pressure on both margins and profitability. A key consideration for owners is their ability to pass on these costs to customers. It is expected that

AHR EXPO 2023 TAKEAWAYS (continued)

equipment costs will remain high (or retreat slowly) but that general supplies and accessory prices will retreat quickly to a more normalized level. Overall, it seems that most have been successful in raising prices to cover increased costs. However, it also depends on the end-market and the demand dynamics of the customer base.

Addressing the implications of a wider economic recession on the industry, the overall outlook and mood from AHR Expo attendees was upbeat. Most companies remain optimistic, driven by rising demand for energy-efficient systems, increased adoption of smart home technology, and growing concern about climate change and the need for cleaner energy.

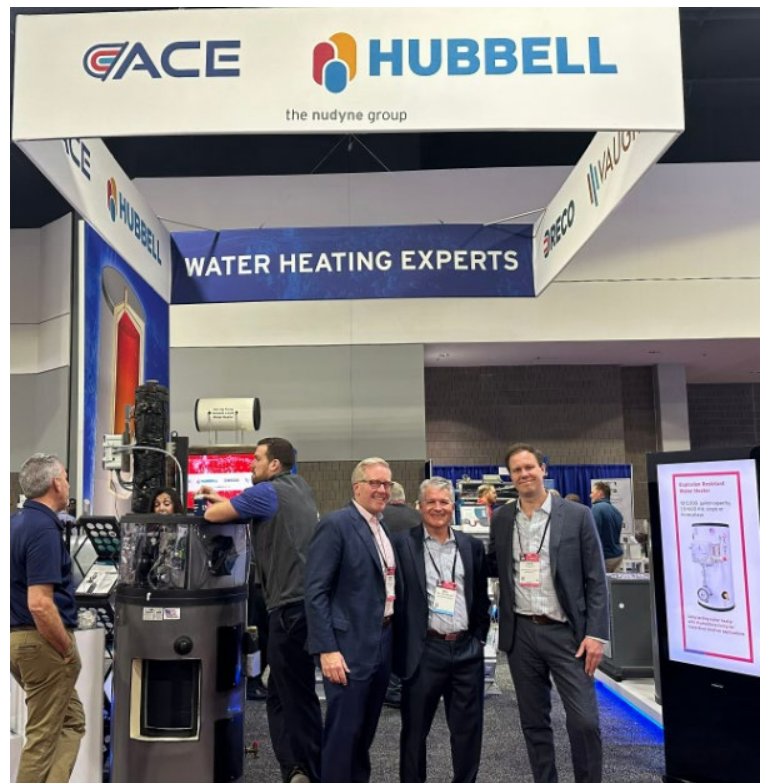
4. Labor shortage & diversity

The skilled labor shortage was another key theme at AHR 2023. With an aging workforce, the HVAC industry desperately needs to appeal to a younger and more diverse population. Experts on the keynote “State of the Industry” panel highlighted asymmetries in the HVAC labor force, citing how women currently account for only 3% of the industry, versus the wider US economy of 47%. They also noted that the HVAC labor pool continues to shrink despite end-market demand rising. We have heard, especially from service companies, that business revenue could be 20-30% higher (or more!) if they could only find skilled labor. On a positive note, as HVAC education and certification classes have successfully migrated online, training has become more convenient and accessible for aspiring tradespeople. Independent business owners with strong training programs can more nimbly compete for workers in a competitive environment while also driving growth in their businesses.

5. M&A is growing in importance

We found that both buyers and sellers at the AHR Expo were still very enthusiastic about the M&A landscape in 2023, particularly in the middle market, for those seeking economies of scale, access to new technologies, expanded geographic presence and more diversified customer bases. Both strategic buyers and private equity investors remain bullish about the overall HVAC market and are actively seeking new opportunities.

Generally speaking, while 2021 and most of 2022 set all kinds of new records, given the supply (sellers) and demand (buyers and investors) dynamics in light of the overall economic and financial markets, we expect that 2023 will be both more volatile and bifurcated. Strong, well-run companies (above average growth, margins, management, market presence) will continue to be highly valued, whereas weaker companies will likely trade at a significant discount in light of tightening credit markets and an unstable economic outlook.



AHR EXPO 2023 TAKEAWAYS (continued)

We expect valuations for companies in HVAC to remain high as demand for good investments far outstrip available opportunities. Drilling deeper, there are unique dynamics that determine valuation parameters for each subsector within HVAC, and we consider those dynamics for manufacturers, distributors and service providers below. Our overall disclaimer is that each M&A situation is unique and the following observations are approximate guidelines to help owners of family-held and founder-led companies establish a framework for thinking about value for their businesses.

- Equipment manufacturers – Equipment manufacturers comprise a broad cross section of companies, including those that manufacture complex, technologically advanced offerings, and others that produce comparatively low-tech, commoditized products. The more technologically advanced a company's products and offerings are deemed to be, the greater likelihood that they will garner a higher valuation from acquirers. While there is a broad range of values, we see most manufacturers typically transaction in the 8-10x range as a multiple of LTM (last 12-months) EBITDA.

- Distribution & logistics – For OEM vendors, distributors serve as trusted partners who help drive sales, increase market awareness for products and provide necessary training to end-market customers. Recently, distributors have transacted in the 10-12x range as a multiple of LTM EBITDA. Multiples tend to be on the lower end of the range for companies that are smaller (by revenue and/or distribution footprint), lack exclusivity agreements with major OEMs and sell alternative product lines outside of HVAC. For distributors with size, product breadth and a pure-play focus on HVAC, valuation multiples can approach the high end of the stated range and beyond.

- Maintenance & repair and new construction services – This subsector remains a tale of two cities,

specifically regarding providers who service the existing home/building market, versus those tied to new construction. Companies that provide maintenance and repair service to existing residences and commercial buildings are highly sought after by acquirers including industry consolidators and private equity investors alike. These companies may command valuation multiples ranging from a low of 8x for smaller firms that need scale to as high as 15x LTM EBITDA for larger firms with scale (\$10 million EBITDA and above). In contrast, providers focused on new construction are seeing lower M&A demand due to perceived risks associated with housing cycle downturns and non-recurring project-based revenue. As a result, valuations for these companies remain relatively modest, with multiples ranging in the low-to-mid single digit EBITDA range. For companies in this second group, owners should explore adding recurring service businesses to their installation base. In doing so, they can increase their exit valuation multiples and position themselves for a more successful transaction when the time comes.

Parting Thoughts

New regulations, changing customer demands, supply chain disruptions, inflation, and recession are all factors that are impacting the industry, though it is clear that many companies are taking proactive steps to prepare for these challenges and capitalize on the opportunities they present.

Overall, we expect to see powerful tailwinds propelling HVAC industry growth forward, driven by increasing demand for energy-efficient systems, smart home technology, and cleaner energy sources – all translating to a dynamic time for HVAC business owners, whether they are looking to grow their enterprise or considering strategic options such as joint ventures, partnerships or an outright business sale.

SECTOR SPOTLIGHT: HVAC MIDDLE MARKET M&A OUTLOOK – Q1 2023

In mid-2022, many factors were in place to suggest that middle market valuations would take a step back from record levels seen over the previous 12 months. Those elements included increased macro-economic uncertainty, a pullback in cash flow-based debt, and higher interest rates. Q4'22 announced transaction volume and value decreased by approximately 25% and 50% YoY, respectively. Despite those overarching headwinds, recent valuations and transaction activity still compare favorably to longer-term historical trends, particularly when looking at pre-pandemic levels.

Even as challenging deal-related conditions persisted throughout the latter half of 2022, the fourth quarter also revealed notable positive tailwinds setting up for 2023, including expected deceleration of Federal Reserve rate hikes, easing inflationary pressures and positive trends in the public markets.

Into this mix, the HVAC sector, which broadly includes equipment manufacturers, distributors and contractor/service companies, looks to remain resilient, building off momentum in 2022. Carter Morse & Goodrich's own channel checks indicate that would-be acquirers are still very enthusiastic about the M&A landscape for the HVAC industry in 2023, particularly in the middle market, and for independent family-owned and founder-led businesses, where M&A buyers see growth opportunities that allow them to acquire new technologies, expand geographic presence and capitalize on efficiencies and economies of scale to realize synergies and increase revenue and profit of their acquisitions.

Driving that optimism in the HVAC sector is blend of continued market activity from both strategic and private equity investors. Strategic buyers have remained active, acquiring smaller peers to gain market share, expand their product offerings and even consolidate supply chains and distribution channels. Private equity firms, for their part, continue to display an appetite for investing in the sector due to the noted "mission critical" nature of HVAC, from the top of the value chain with equipment & parts, to the distribution channel that remains highly fragmented and ripe for roll-up, to the last mile service/install business models that display the ever-desirable traits of recurring revenue and defensibility. A steady build of M&A activity for quality assets is expected over the course of 2023, helping to continue driving middle market mergers, particularly for independent, family and founder owned businesses in this attractive and resilient sector.



CMG CASE STUDY – WILLIAMS DISTRIBUTING ACQUIRED BY DAIKIN

Business Description

Founded in 1968 and headquartered in Grand Rapids, Michigan, Williams is the leading full-service distributor of heating, ventilation and air conditioning (HVAC) products and residential building products in the Great Lakes region of the United States. Williams operates 32 locations, including 27 dedicated to HVAC, across Michigan, Indiana, and Ohio with 575 employees.

Transaction Background

Williams is a second-and-third-generation family-owned business. Jim Williams, representing the Company's second generation, joined the family business in the 1970's and grew it into one of the most respected distributors in the midwestern US. In 2022, the Williams family decided to explore strategic options to determine the next chapter in the Williams Distributing legacy.

CMG Solution & Outcome

CMG was engaged to conduct a strategic options analysis for Williams in early 2022. Following the outcome of CMG's options analysis, the Williams family mandated CMG to conduct a targeted sale process for the Company. Multiple strategic and financial offers were received, and Williams ultimately selected Daikin as the acquirer.









Daikin, headquartered in Osaka, Japan, is a Fortune 1,000 company with more than 84,000 employees worldwide and is the world's #1 indoor comfort solutions provider.



CMG assisted Williams in the negotiation of the purchase agreement, coordinated due diligence and managed the transaction's closing process. The transaction with Daikin closed in December 2022.

NOTEWORTHY RECENT HVAC M&A TRANSACTIONS

Q1 2023 and Q4 2022 have seen a strong mix of transactions across the equipment, distribution and service verticals.

 <p>acquires</p> 	<ul style="list-style-type: none"> • Beijer Rej, a Sweden-based distributor of HVAC products, acquired Heritage Distribution, a private equity-backed US distributor • This is Beijer's first foothold into the North American market • Transaction closed in January 2023
 <p>acquires</p> 	<ul style="list-style-type: none"> • Daikin acquired Venstar, a founder-led US-based controls and energy management systems provider • The acquisition complements the growing market for Daikin's environmentally friendly indoor comfort technologies • Transaction closed in December 2022
 <p>acquires</p> 	<ul style="list-style-type: none"> • Private equity-backed Sila Services acquired Total Climate Controls, Inc., a family-owned HVAC service provider based in Boscawen, NH • With Sila continuing its rapid growth through M&A, the transaction expands Sila's market presence across the New England region • Transaction closed in November 2022
 <p>acquires</p> 	<ul style="list-style-type: none"> • Private equity-backed Integra Testing Services acquired RSAnalysis and RSACx, a founder-led testing, adjusting and balancing (TAB) services provider • The addition expands Integra's presence nationally, adding five office locations to Integra's nine office locations across the US • Transaction closed in October 2022

SELECT HVAC M&A TRANSACTIONS - Q4 2022

Date	Acquirer	Target	Target Description
<i>Distribution Deals</i>			
Dec-22	Daikin Industries, Ltd.	Williams Distributing Co.	Distributor of HVAC equipment and parts, plumbing and building products in the Great Lakes region.
Dec-22	Service Champions, Inc.	M and M Heating and Air Conditioning	Offers solutions for heating, cooling, plumbing, and electrical equipment.
Dec-22	Beijer Ref AB	Heritage Distribution Holdings	HVAC/R parts and equipment distribution platform.
Dec-22	Ferguson plc	Airefco, Inc.	Distributes HVAC equipment to commercial and residential markets in the Northwest.
Nov-22	The Master Group	Fortress Group Inc.	Wholesale distributor of HVAC equipment.
Nov-22	Munch's Supply	BellSimons	Engages in the distribution of heating, air conditioning, refrigeration, and plumbing supplies.
Oct-22	Gryphon Investors Inc.	Coastal Supply Co., Inc.	Distributes heating, ventilation, and air conditioning parts to serve customers across the east Tennessee market.
<i>Manufacturing Deals</i>			
Dec-22	Daikin Industries, Ltd.	Venstar, Inc.	Designs, manufactures, and supplies thermostats and energy management systems.
Oct-22	Peak Capital Inc.	Penn Pump & Equipment Company Inc.	Engages in manufacturing and distributing plumbing and HVAC pumping products.
<i>HVAC Service Deals</i>			
Nov-22	Sila Heating & Air Conditioning	Total Climate Control, Inc.	Provides plumbing, heating, and cooling services to homeowners and businesses.
Nov-22	Service Champions, Inc.	Service Wizard, Inc.	Provides air conditioning, heating and air quality services in Austin, Texas.
Nov-22	Rush Street Ventures	Official Heating and Cooling, Inc.	Provides residential heating, cooling, plumbing and duct cleaning services.
Oct-22	Integra Testing Services, LLC	RSAnalysis Inc. / RSACx	HVAC testing, adjusting and balancing services.
Oct-22	CPS Capital	Total Comfort Heating & Air Conditioning LLC	Offers heating, ventilation, and air conditioning repair and installation services.
Oct-22	CPS Capital	Integrity Heat & Air, LLC	Provides heating, ventilating and air conditioning services.

SELECT PUBLIC COMPANY DATA

(As of 1/31/2023)

Company	Market Information		LTM Financials		Operating Metrics		TEV to LTM	
	\$ / Share	TEV	Revenue	EBITDA	Growth	EBITDA%	Revenue	EBITDA
1/31/2023								
Manufacturers								
Honeywell	\$208.48	\$149,816	\$34,937	\$8,419	0.9%	24.1%	4.3x	17.8x
Johnson Controls International	\$69.57	\$55,870	\$25,299	\$2,759	6.9%	10.9%	2.2x	20.2x
Daikin Industries	\$172.17	\$50,486	\$28,692	\$4,228	26.5%	14.7%	1.8x	11.9x
Trane Technologies	\$179.12	\$45,020	\$15,487	\$2,579	12.7%	16.7%	2.9x	17.5x
Carrier Corporation	\$45.53	\$44,804	\$20,449	\$4,897	1.9%	23.9%	2.2x	9.1x
Ingersoll Rand	\$56.00	\$24,072	\$5,711	\$1,149	15.3%	20.1%	4.2x	20.9x
Lennox International	\$260.62	\$10,925	\$4,589	\$694	10.8%	15.1%	2.3x	14.9x
A. O. Smith	\$67.70	\$10,228	\$3,813	\$732	12.9%	19.2%	2.7x	33.0x
Aaon	\$76.32	\$4,127	\$770	\$120	47.7%	15.5%	5.4x	34.5x
SPX	\$75.01	\$3,453	\$1,382	\$108	13.8%	7.8%	2.5x	28.1x
Modine Manufacturing	\$23.89	\$1,551	\$2,196	\$212	11.3%	9.6%	0.7x	7.3x
Mean	\$112.22	\$36,396	\$13,030	\$2,354	14.6%	16.2%	2.8x	19.6x
Median	\$75.01	\$24,072	\$5,711	\$1,149	12.7%	15.5%	2.5x	17.8x
Services								
API Group (Minnesota)	\$22.24	\$8,614	\$5,967	\$478	60.8%	8.0%	1.4x	18.0x
Emcor Group	\$148.25	\$7,375	\$10,766	\$644	12.8%	6.0%	0.7x	11.5x
Comfort Systems USA	\$121.04	\$4,752	\$3,879	\$306	33.0%	7.9%	1.2x	15.5x
Tutor Perini	\$9.17	\$1,093	\$3,921	\$33	(20.9%)	0.9%	0.3x	32.7x
IES Holdings	\$39.81	\$945	\$2,167	\$81	41.0%	3.7%	0.4x	11.6x
Taikisha	\$27.24	\$680	\$1,628	\$122	(5.0%)	7.5%	0.4x	5.6x
Sanki Engineering	\$11.94	\$421	\$1,468	\$72	(5.5%)	4.9%	0.3x	5.9x
Limbach Holdings	\$12.87	\$160	\$480	\$20	(2.8%)	4.2%	0.3x	7.9x
Nippon Air Conditioning Services Company	\$5.41	\$146	\$403	\$24	2.3%	6.1%	0.4x	6.0x
Mean	\$44.22	\$2,687	\$3,409	\$198	12.9%	5.5%	0.6x	12.7x
Median	\$22.24	\$945	\$2,167	\$81	2.3%	6.0%	0.4x	11.5x
Distributors								
Ferguson (UK)	\$142.34	\$33,832	\$29,694	\$3,222	22.6%	10.9%	1.1x	10.5x
Watsco	\$287.37	\$11,676	\$7,205	\$848	21.6%	11.8%	1.6x	13.8x
Reece	\$11.36	\$8,549	\$5,874	\$436	24.8%	7.4%	1.5x	19.6x
Beijer Ref	\$14.15	\$5,684	\$2,182	\$254	31.5%	11.7%	2.6x	22.3x
Global Industrial	\$26.29	\$1,089	\$1,168	\$117	8.6%	10.0%	0.9x	9.3x
Mean	\$96.30	\$12,166	\$9,224	\$975	21.8%	10.3%	1.6x	15.1x
Median	\$26.29	\$8,549	\$5,874	\$436	22.6%	10.9%	1.5x	13.8x
Mean - All	\$84.56	\$19,415	\$8,805	\$1,302	15.4%	11.1%	1.8x	16.2x
Median - All	\$56.00	\$7,375	\$3,921	\$436	12.8%	10.0%	1.5x	14.9x

TEV = Total Enterprise Value; LTM = Last Twelve Months

\$ in millions, except per share data

Source: Pitchbook

M&A Expertise for Founders & Families

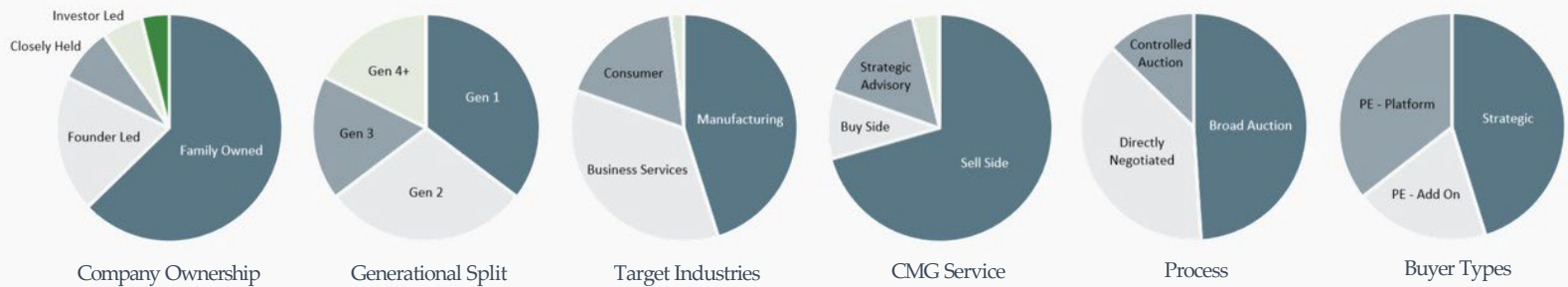
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Carter Morse & Goodrich is a boutique M&A advisory firm specialized in advising closely-held and family businesses valued between \$25 million and \$250 million. We are uniquely focused on helping entrepreneurs, families, and family-owned businesses achieve their once-in-a-lifetime M&A transactions.

Located in Southport, Connecticut, CMG specializes in helping owners of leading companies operating in unique markets plan, prepare, execute, and close successful transactions that maximize shareholder value. We fully understand and appreciate the unique dynamics of closely-held family businesses and the importance of their legacies.

For 35 years, the combination of our hands-on approach, senior banker attention, strategic guidance, seamless transaction execution and extensive network of domestic and international resources has enabled us to become a trusted advisor to hundreds of business owners.

Our Client Profile



Select Transactions



CMG By The Numbers

1987
FOUNDED

450+
CLIENT ENGAGEMENTS

\$6 Billion +
AGGREGATE TRANSACTION VALUE

1 Objective
SUCCESSFUL CLIENT OUTCOMES

Recent Industry Awards



2022 Winner
Industrial Tech
Deal of the Year



2022 Winner
International Strategic
Deal of the Year
(Over \$100 million)



2022 Winner
Corporate
Deal of the Year



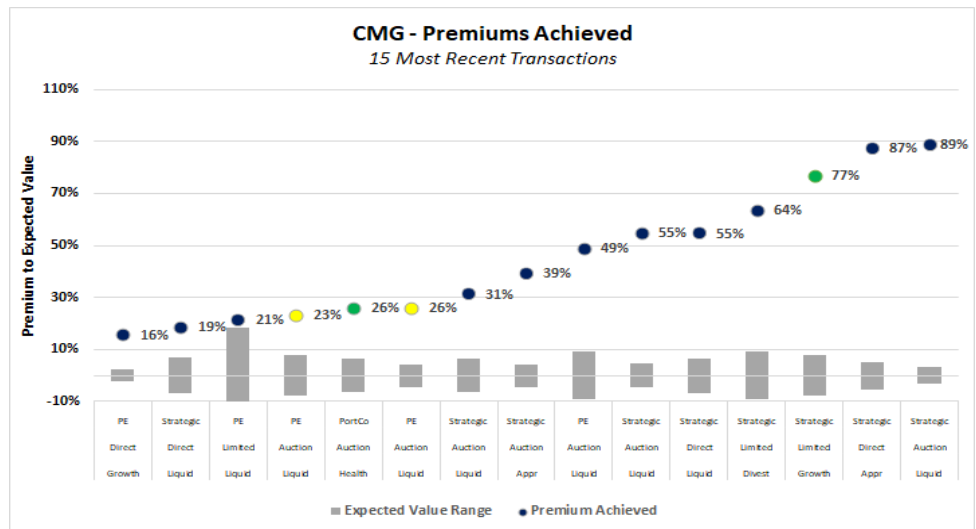
2022 Winner
Top 50 Investment Bank
(Industrials)



2021 Winner
Private Equity
Deal of the Year

Exceeding Client Expectations

- Selective about the engagements we take on to ensure a positive outcome for our clients
- Proud of our record of careful analysis, thoughtful positioning to investors and attentive management of a disciplined transaction process
- Dedicated to helping clients Maximize Shareholder Value, and regularly exceed client expectations



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Carter Morse & Goodrich is a founding partner of the Alliance of International Corporate Advisors (AICA), which enables us to deliver an exceptional combination of global breadth and local knowledge to each of our engagements through close collaboration with more than 365 colleagues within 40 partner firms in 40 countries across the globe.

338

Deals Closed

40

Member Firms

40

Countries

62

Offices

365+

Professionals

6

Continents

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