



INDUSTRY OUTLOOK

# HVAC Industry (Canada)

1H-2022

## Executive Summary

The 1H-2022 has been a turbulent period for HVAC manufacturers and service providers. While non-residential construction markets are still recovering, their slowed activity poses growth challenges. In addition to inflation, the inaccessibility of supplies has also created pressure for industry incumbents as they compete to manage gross margins. Since the start of the year, manufacturers have responded with hefty price increases. Despite the challenges above, HVAC M&A levels have remained stable, as demonstrated by the many deals announced and closed thus far.

### *Recent HVAC Acquisition Trends*

Moving forward, acquisitions for technological capabilities are expected to continue, given the preference for sustainable and energy-efficient HVAC systems in recent years. In 2021, a prominent transaction was Kontrol Technologies Corporation's acquisition of Global HVAC & Automation Incorporated (June 2021). Kontrol has a portfolio of HVAC products that utilizes cloud-based technology and IoT to optimize energy and emission control. Global HVAC, on the other hand, provides HVAC automation and installation services in new and retrofit buildings<sup>1</sup>.

In 1H-2022, energy management companies have shown interest in HVAC companies and vice versa. Action Furnace's acquisition of Direct Energy Alberta Home Services is an example of this (January 2022). Energy management companies are looking to reduce energy costs to end users<sup>2</sup>. By acquiring HVAC, it allows them to identify energy-saving solutions while having the ability to install said solutions through the target company<sup>3</sup>.

### *Canadian Deal Market Summary*

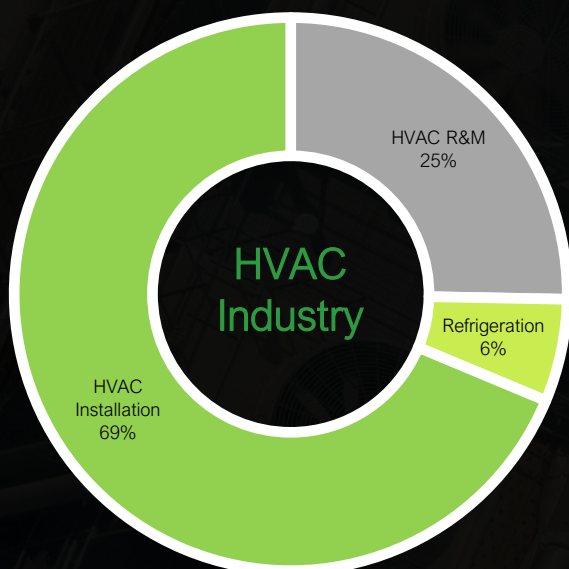
During the 1H-2022, there were 201 private equity deals, representing \$25B of capital invested in transactions, and a total of 730 M&A deals, representing \$115B of capital invested in transactions. Thus far, deal volumes have slowed while the total capital invested per quarter remained stable for Canadian deals since 4Q 2021<sup>4</sup>.

Overall, the industry experienced a slower pace of installation revenues due to a decline in construction activity and housing starts. Despite this, operators still have a protective moat for revenue generated from maintaining and repairing existing systems, given their essential nature. As industry revenue recovers, tracking and rating energy efficiency become vital as government incentives require assessing energy efficiency to determine improvement while encouraging demand.

All figures are in CAD unless otherwise stated.



# Overview



## Key Stats in 1Q 2022 compared to 4Q 2021<sup>5</sup>

| Metric                                     | Increase/decrease (%) |            |
|--------------------------------------------|-----------------------|------------|
| Investment in non-residential construction | ↓                     | 0.83% QoQ  |
| Investment in commercial construction      | ↑                     | 2.15% QoQ  |
| Investment in residential construction     | ↓                     | 11.55% QoQ |
| Overall investment in construction         | ↓                     | 8.7% QoQ   |
| Housing starts                             | ↓                     | 29.87% QoQ |
| Wages and salaries                         | ↑                     | 1.04% QoQ  |
| Household spending on durable goods        | ↑                     | 2.37% QoQ  |

## HVAC Industry – 1Q 2022 vs 4Q 2021

- The Canadian **Heating and Air-Conditioning Contractors** industry is highly dependent on construction activity across Canada, as majority of the revenue (approx. 68%) is generated from HVAC installations and renovations<sup>6</sup>.
- Due to the steep decline of **housing starts** in 1H-2022, the revenue of industry contractors was impacted. The new residential building segment, in particular, is a significant revenue stream for installing HVAC equipment and ducting<sup>7</sup>.
- Per capita disposable income is an important driver as the industry relies on homeowners for HVAC upgrades and maintenance services revenue. **Household spending on durable goods** has minimally increased by +2.37% vs. +1.30% in 4Q 2021<sup>8</sup>. However, inflation and interest rate changes are likely to influence purchasing decisions.
- While **wages & salaries** has had a low to stable increase, the rise in energy prices which has contributed to inflation may motivate property owners to invest in newer and more energy-efficient HVAC systems<sup>9</sup>.
- Investment in non-residential construction** has continued to decline and poses a concern for the industry. High revenue concentration stems from private investment in non-residential construction for commercial (4.2%), industrial (5.8%), institutional (8.5%), and retail (8.2%) structures as they support sales related to installing, maintaining, and repairing HVAC/refrigeration systems<sup>10</sup>.



## Market Growth

# Industry Trends

A potential recovery in non-residential construction creates new opportunities as the value of technologically advanced HVAC systems are challenged by macro headwinds.

### Industry Shapers

While the HVAC industry has had stable growth, demand for HVAC goods and services vary by province due to varying weather regions within Canada. As a result, provincial differences in installation costs, government tax initiatives, and availability of labour reflect these geographical climate differences.

In 2022, industry revenue showed recovery as non-residential construction markets had new activity. Specifically, there was increased demand from the educational sector. To support COVID-19 safety plans, governments have invested in public schools to optimize air quality. In British Columbia, the government invested \$13 million to improve ventilation and HVAC systems for the Safe Return to Class Fund<sup>11</sup>. Ontario made an additional investment of \$50 million for HVAC alternatives such as portable high-efficiency particulate absorbing (HEPA) filters<sup>12</sup>. Thus, K-12 schools will be a fast-growing segment due to an influx of government investments. Overall, installations from this sector are expected to account for 8.5% of revenue in 2022<sup>13</sup>.

### Key Materials

As a result of government policies focusing on infrastructure improvements, the cost of steel and copper has risen. In the coming years, competing demand will stem from other industries, such as the emergence of electric vehicles, as they require nearly four times more copper than internal combustion engine vehicles<sup>14</sup>.

Compared to aluminium, copper is a highly anti-corrosive metal that handles oxidation well and for lengthier periods. For that reason, copper is an essential material as its use in piping helps prolong an air conditioner's lifespan<sup>15</sup>. However, the volatility of copper prices through 1H-2022 poses an inventory concern. After months of rampant price spikes, copper prices have approached 2020 price levels. As of June 2nd, copper's price has been declining due to muted demand from China, given its economy's lockdown<sup>16</sup>. However, prices may sharply rebound as China resumes participation.

### Supply Chain & HVAC Components

Through 1H-2022, service providers completing maintenance or repairs required additional time as components were not readily available. The lack of necessary components also impedes manufacturers as production levels are slowed, and their ability to achieve energy efficiency objectives becomes disrupted<sup>17</sup>. A prime example is the impact of microchip shortages due to the industry's reliance on HVAC control systems.

“ The most important materials we purchase are steel, copper, and aluminium... We are not dependent upon any one source for raw materials or the major components... By having multiple suppliers, we believe that we will have adequate sources of supplies to meet our manufacturing requirements for the foreseeable future. ”

– Gary Fields, President, CEO, AAON, Inc.  
(March 3<sup>rd</sup>, 2022)

### New Technologies & Innovation

Global shipments of Smart HVAC controls in North America are expected to surpass 250 million units by 2024<sup>18</sup>. The benefit of controls serves homeowners and operators as the real-time data collection can be used to monitor energy-efficiency and indicate maintenance or serving needs<sup>19</sup>. However, chip shortages and a low supply of related components are disrupting this innovation and, in turn, may impact its adoption and future sales.

### Inflation & Interest Rates

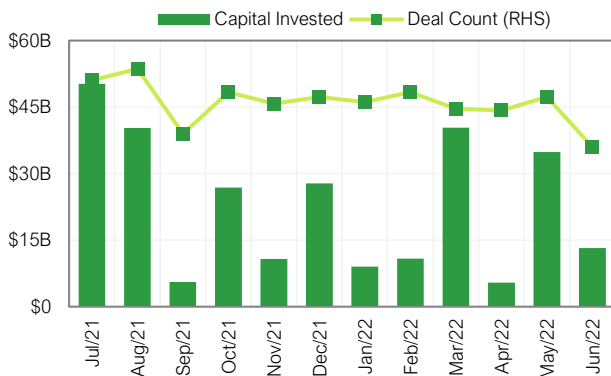
The interest rate hikes in March 2022 (+0.25%), followed by additional hikes in April 2022 and June 2022 (+0.50% each), have affected industry demand as financing HVAC systems are commonly preferred over renting<sup>20</sup>. Manufacturers often offer financing through banks or other third-party lenders. As a result, cost savings associated with previously low rates, energy-efficient systems, or tech-enabled HVAC systems were eroded by unprecedentedly high rates. In June, annual consumer price gains hit a three-decade high of +7.7%, with CPI data now including more weight towards gasoline<sup>21</sup>.

## Industry Valuations

# Mergers and Acquisitions (M&A)

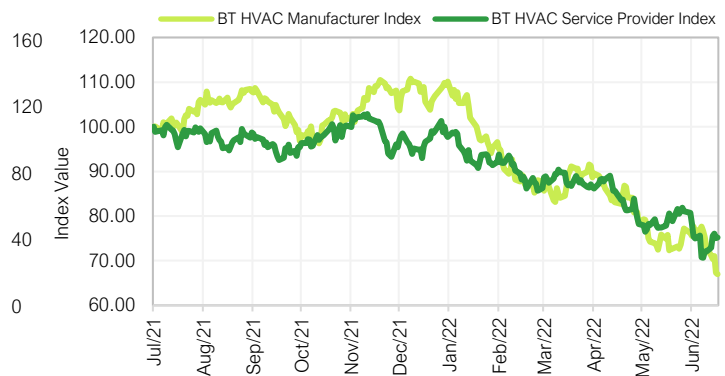
In 1H-2022, there were 201 private equity deals, representing \$25B of capital invested in transactions, and a total of 730 M&A deals, representing \$115B of capital invested in transactions. Thus far, deal volumes have slowed while the total capital invested per quarter remained stable for Canadian deals since 4Q 2021<sup>22</sup>. *Note: Private company multiples may vary significantly lower from those of public traded companies.*

**M&A Transactions in Canada**



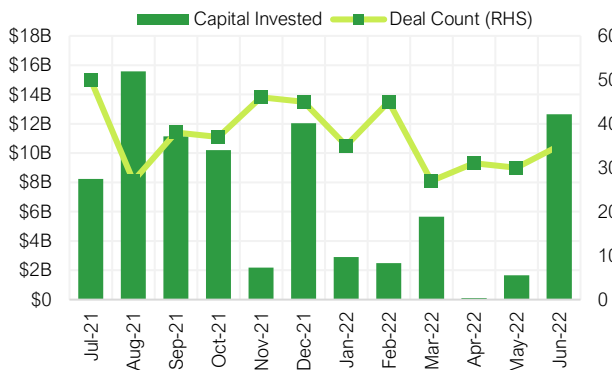
Source: PitchBook Data, Inc.

**TTM Public HVAC Share Price Performance**



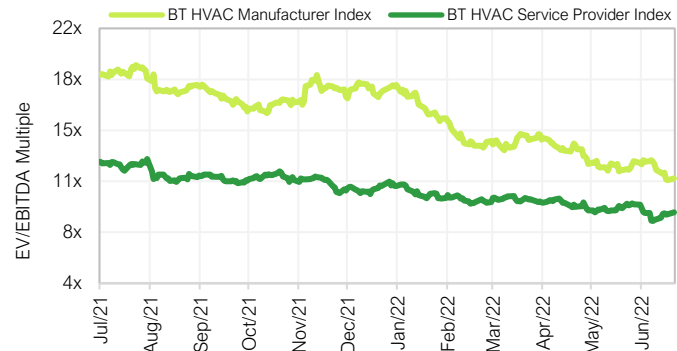
Source: Capital IQ | Market-Capitalization Weighted

**Private Equity Transactions in Canada**



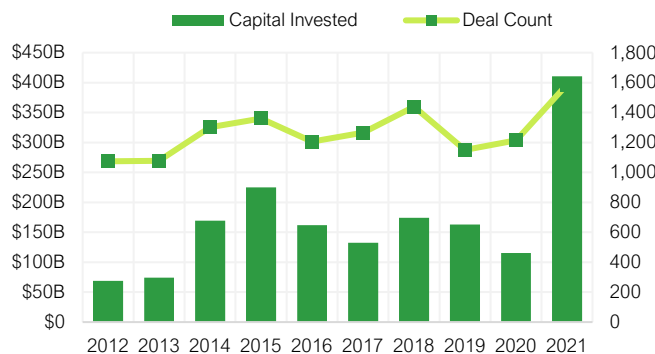
Source: PitchBook Data, Inc.

**TTM Public HVAC Manufacturing & Servicing EV/EBITDA**



Source: Capital IQ | Market-Capitalization Weighted

**Long Term M&A Trends in Canada (last 10 years)**



Source: PitchBook Data, Inc.

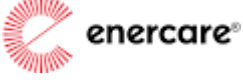
BT HVAC Manufacturer Index: AAON Inc, Carrier Global Corp, Comfort Systems USA Inc, Johnson Controls International PLC, Lennox International Inc, SPX Corporation, Trane Technologies PLC, Watsco Inc

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

## Recent M&A Transactions

# Select Transactions

Notable HVAC transactions in Canada over the past two years include<sup>23</sup>:

| Companies                                                                                                                                                                          | Deal Date   | Deal Type  | Investors                                                                                                                           |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|------------|-------------------------------------------------------------------------------------------------------------------------------------|
|  <b>SMOGBUSTER™</b>                                                                               | 02-Jun-2022 | M&A        |  <b>MIKISEW</b><br>PRIDE OF A NATION             |
|  <b>wardlaw</b><br>Heating + Air Conditioning + Plumbing + Electrical                             | 01-Apr-2022 | M&A        |  <b>RightTime</b><br>GROUP OF COMPANIES          |
|  <b>intertape polymer group®</b>                                                                  | 08-Mar-2022 | M&A        |  <b>CLEARLAKE</b>                                |
|  <b>LMP</b>                                                                                       | 21-Feb-2022 | M&A        |  <b>evapco</b>                                   |
|  <b>AIRIA BRANDS INC.</b>                                                                         | 18-Feb-2022 | M&A        |  <b>zehnder</b>                                  |
|  <b>Precision Refrigeration</b><br>• Service • Install • Maintenance                              | 25-Jan-2022 | M&A        |  <b>The Arcticom Group®</b>                      |
|  <b>ENERGERE</b>                                                                                 | 21-Jan-2022 | M&A        |  <b>GDI</b> <b>Integrated Facility Services</b> |
|  <b>TRANSOM</b>                                                                                 | 20-Jan-2022 | M&A        |  <b>MESTEK, INC.</b>                           |
|  <b>Syles</b><br>MECHANICAL SERVICES LTD.                                                       | 18-Jan-2022 | M&A        |  <b>enercare®</b>                              |
|  <b>Direct Energy Home Services</b>                                                             | 04-Jan-2022 | M&A        |  <b>ACTION FURNACE</b>                         |
|  <b>VRE Systems</b>                                                                             | 14-Dec-2021 | Buyout/LBO |  <b>FIREPOWER CAPITAL</b>                      |
|  <b>ClimateAir</b><br>HEATING + COOLING + PLUMBING + ELECTRICAL                                 | 09-Dec-2021 | Buyout/LBO |  <b>RightTime</b><br>GROUP OF COMPANIES        |
|  <b>furnaceguys®</b><br>HOME HEATING & COOLING                                                  | 18-Oct-2021 | Buyout/LBO |  <b>RightTime</b><br>GROUP OF COMPANIES        |
|  <b>GREYSTONE ENERGY SYSTEMS INC.</b>                                                           | 29-Sep-2021 | Buyout/LBO |  <b>bemsiq</b>                                 |
|  <b>LISI MECHANICAL</b>                                                                         | 15-Sep-2021 | M&A        |  <b>Ethel Capital Corporation</b>              |
|  <b>Anchor Home Comfort</b>                                                                     | 10-Aug-2021 | Buyout/LBO |  <b>RightTime</b><br>GROUP OF COMPANIES        |
|  <b>QSD®</b><br>Since 1981                                                                      | 01-Aug-2021 | Buyout/LBO |  <b>NICOLA WEALTH &amp; RØNIN</b>              |
|  <b>Valley Mechanical Inc.</b><br>Commercial • Industrial • Process • Non-Hazardous Contractors | 01-Aug-2021 | M&A        |  <b>METRO GROUP</b>                            |
|  <b>HAVEN HOME CLIMATECARE</b><br>THE HEATING AND COOLING PROFESSIONALS WHO CARE                | 16-Jul-2021 | Buyout/LBO |  <b>RightTime</b><br>GROUP OF COMPANIES        |
|  <b>GLOBAL HVAC and Automation</b>                                                              | 30-Jun-2021 | M&A        |  <b>KONTROL TECHNOLOGIES CORP.</b>             |

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.

## Key Findings

# Industry Snapshot

Balancing margins and sustainable HVAC considerations become challenging as the dynamic macroenvironment provides decision-making pressure on industry operators.

## Current and Prospective Performance

|        | Gross Margin * |           | EBITDA Margin * |           |
|--------|----------------|-----------|-----------------|-----------|
|        | Manufac.       | Servicing | Manufac.        | Servicing |
| High   | 35%            | 48%       | 17%             | 22%       |
| Low    | 18%            | 9%        | 8%              | 4%        |
| Mean   | 28%            | 23%       | 13%             | 9%        |
| Median | 28%            | 18%       | 14%             | 7%        |

Source: Capital IQ

## Looking Forward

Canada has a project count of 205 for LEED-certified buildings (a widely used green building rating system), making it ranked second in the world in 2021<sup>24</sup>. With green buildings becoming more prevalent and increasing government investment in green infrastructure, HVAC will experience demand for Greenhouse Gas Intensity (GHGI) approved systems. GHGI is an industry metric that measures greenhouse gas emissions associated with the energy (heating, lighting, air conditioning, etc.) required to operate a building<sup>25</sup>. As requirements tighten, the demand for efficient HVAC equipment used in construction markets is expected to rise<sup>26</sup>.

As future costs remain uncertain in a dynamic macroeconomic environment, operators may have to pass costs onto consumers. As exemplified by price increases in 1H-2022, many manufacturers have raised prices anywhere from 3% to 20%<sup>27</sup>.

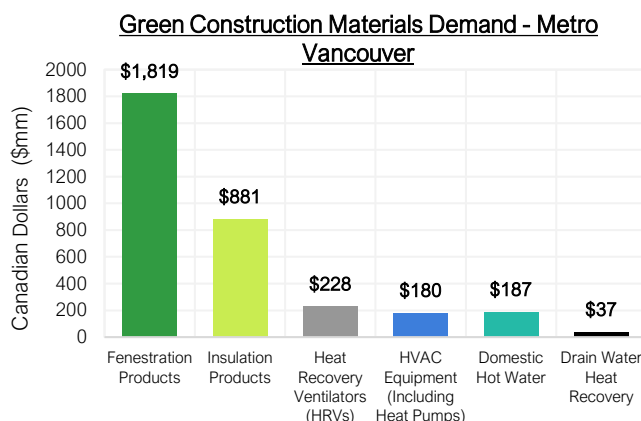
## Industry Outlook

“Secular trends related to decarbonization and indoor air quality are leading to a shift in demand from standard equipment to more capable, higher sophisticated equipment that is more energy efficient while providing cleaner air quality.”

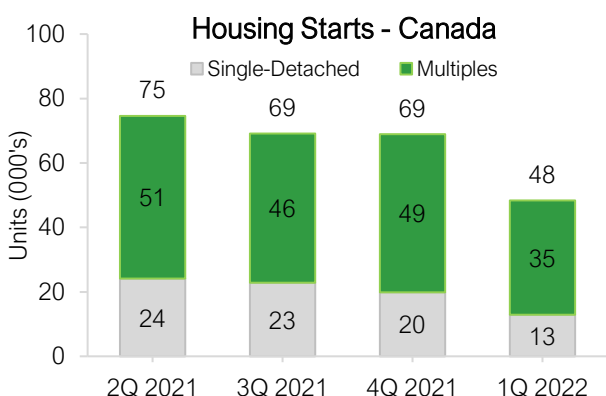
– Gary Fields, President, CEO, AAON, Inc.  
(March 3<sup>rd</sup>, 2022)

## Conclusion

As rampant inflation influences the rise in operating expenses, component costs, and interest rates, it poses a sustainability concern for industry gross margins for 2H-2021. On one hand, there is a supply-side debate on whether energy-efficient HVAC systems will be worthwhile for manufacturers to produce. On the other hand, there is a demand-side debate on whether consumer demand for them persists as cost savings become offset. Moving forward, navigating supply chain issues may involve having multiple suppliers, using derivative instruments, or entering guaranteed supply contracts.



Source: Vancouver Economic Commission

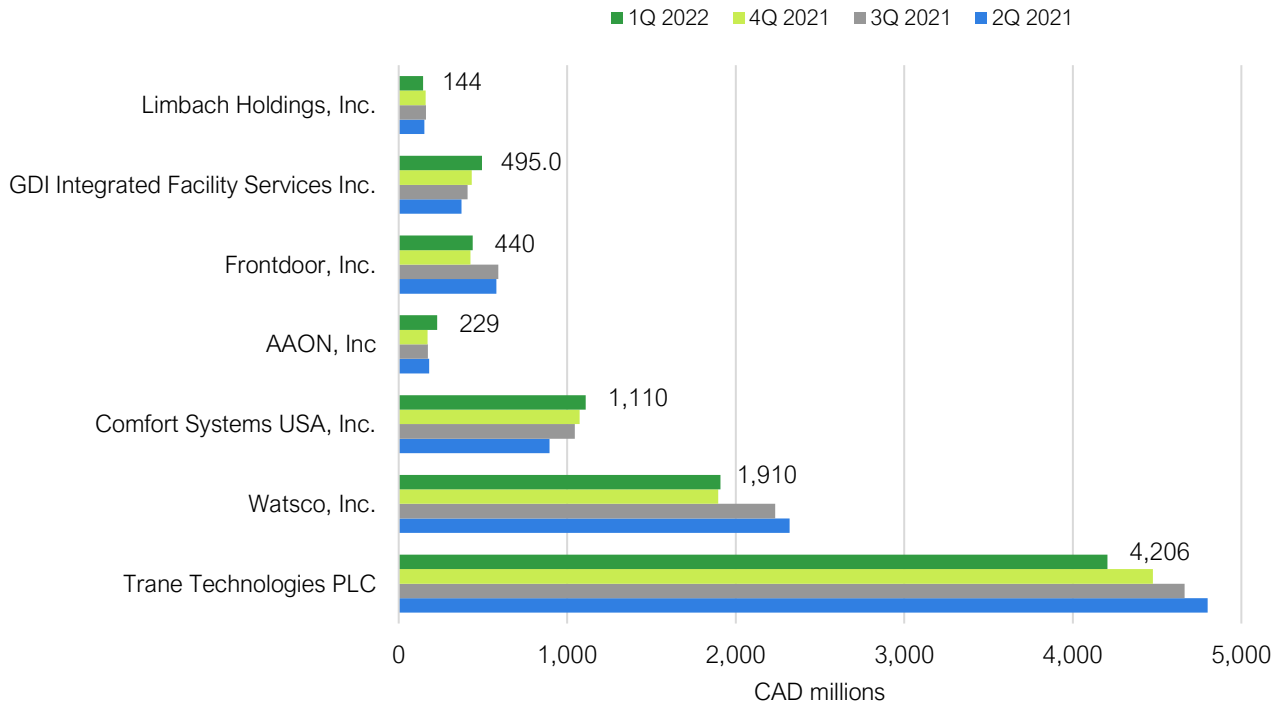


Source: Statistics Canada

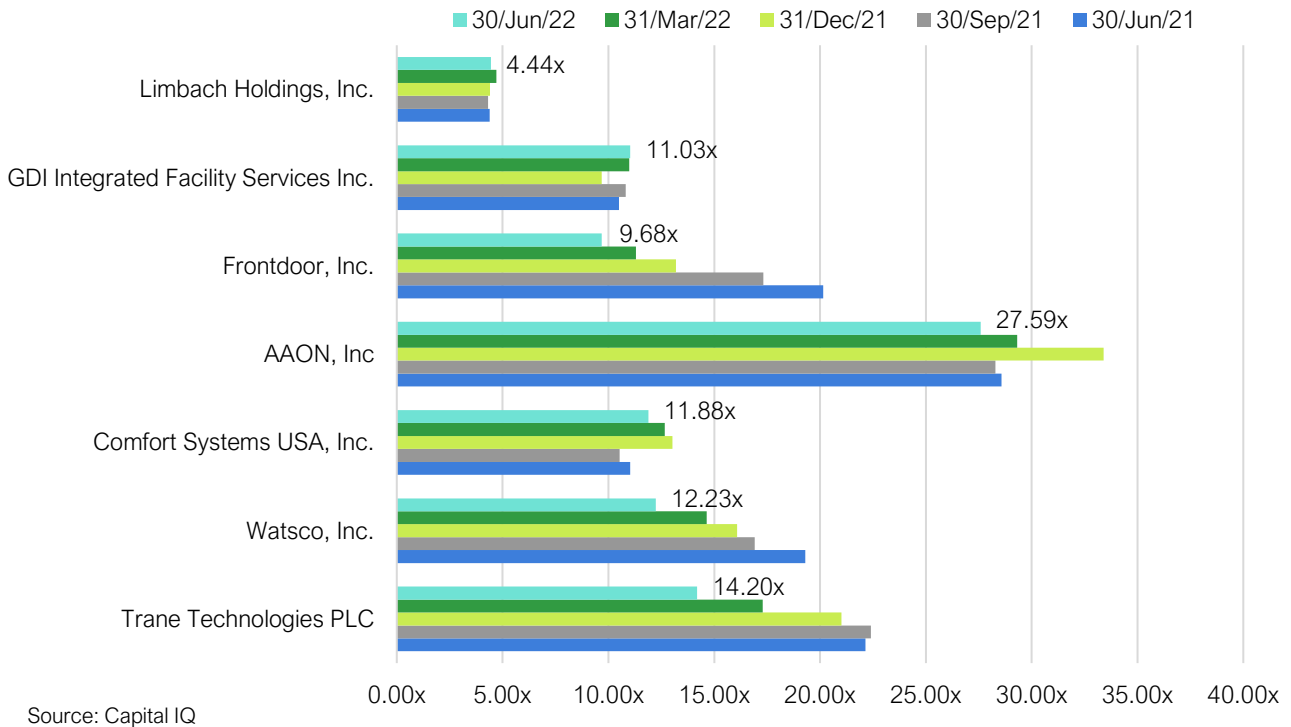
## Key Findings (Continued)

### TTM performance of key industry players – 1Q-2022

2021-2022 Quarterly Revenue (Select Public Companies)



2021-2022 EV/EBITDA Multiples (Select Public Companies)





## 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 an exclusive financial advisor to Latham's in structuring and negotiating this transaction.**



### 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 an exclusive financial advisor to Pacific West Mechanical in structuring and negotiating this transaction.**

# 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 a 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.*

## Testimonial

### Past Client: PacWest

“

*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.



## Endnotes

# Sources

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## Corporate Finance

# Why Baker Tilly?

### About Us

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| <br><b>Transaction Services</b>                                 | <br><b>Lead Advisory</b>                                                                                                                   | <br><b>Valuation</b>             | <br><b>Tax Structuring</b>                | <br><b>Consulting</b>                                                                         |
|----------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"><li>- Financial and Tax Due Diligence</li><li>- Focused scope on issues that are most important to you</li></ul> | <ul style="list-style-type: none"><li>- Deal strategy and origination</li><li>- Negotiation and structuring advice</li><li>- Preparation of Term Sheet</li><li>- SPA advice</li><li>- End-to-end project management</li></ul> | <ul style="list-style-type: none"><li>- Modelling</li><li>- Valuation</li><li>- Purchase Price Allocation</li></ul> | <ul style="list-style-type: none"><li>- Tax structuring planning and implementation</li><li>- Tax structuring advice</li></ul> | <ul style="list-style-type: none"><li>- Operational due diligence</li><li>- Commercial due diligence</li><li>- Synergy assessment</li><li>- Post-acquisition integration</li></ul> |

**Ongoing transaction project management**

**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**

## Contact Baker Tilly Corporate Finance



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