The Facilities Services Space: M&A Resurgence

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Unlike most industries through this long, seemingly unending recession, the facilities services industry (generally defined to include such service categories as janitorial, mechanical, electrical, HVAC, security, landscape, and pest management) has seen a relatively steady, albeit lesser, diet of merger and acquisition activity. That said, as optimism for the future has risen on various levels, we are witnessing the early stages of a resurgence in mergers and acquisitions within the industry, the most recent notable transactions being February's acquisition of The Hurley Group, based in Toronto, Canada, by The Compass Group, and last month's purchase of Diversified Maintenance Systems, Inc., headquartered in Tampa, Florida, by private equity firm, Frontenac Company.

The industry never really did see a complete quieting of strategic or financial transactions during the down market of the past couple years. That market began to surface on the heels of the acquisition by ISS of Sanitors, Inc., a roughly $400 million company at the time, in mid 2007. Subsequently, through its subsidiary North American entity, ISS Facility Services, Inc., it made notable acquisitions of BG Service Solutions, Kansas City, Kansas, in 2008, and Central Property Services and Central Security Services, Pittsburgh, Pennsylvania, in early 2009. Also in early 2009, The Compass Group acquired Kimco Corporation, a $100 million plus company based just outside of Chicago, Illinois. Leading the charge relative to financial acquirers was Palladium Equity Partners, LLC and its acquisition in late 2009 of Capital Contractors, Inc., a Long Island, New York based company with a presence throughout North America. Beyond these more significant industry transactions were a host of smaller regional and local ones involving both strategic and financial buyers.

We believe the industry's M&A momentum was kept in relative tact throughout the global market downturn mostly as a result of its historic validation of being recession resistant, amongst the industry's more appealing attributes. Commercial, industrial and institutional properties of all types simply must be maintained to certain standards regardless of the economic climate. And the costs to do so can be cut only so much. In addition, the industry still has good long term growth prospects, led by ongoing, and in fact increasing, sustainability demands, and remains highly fragmented, making it an appealing space for build-up and consolidation strategies.

As we now have entered the second decade of the new millennium, the end of the recessionary tunnel appears to be in site. Panic and fear have been replaced with optimism, albeit cautious, as conventional wisdom suggests that if nothing else we've seen the worst of the economic downturn and financial crisis. Over the past several months now, global M&A activity has increasingly picked up coinciding with such positive signs as the rising stock market and relatively high amounts of pent-up system liquidity led by a near record amount of private equity capital available for investment.

With these macro trends have come similar effects with respect to the facilities services industry. According to William Blair & Company's Facility Services Industry Update Report for February 2010, deal activity for the sector was up in the fourth quarter of 2009 versus the same period in 2008, with 26 total transactions being completed. And as already referenced herein, 2010 has gotten off to a good start with the completion of two relatively significant transactions, as well as several other smaller transactions. In addition, we are aware as of this writing of a handful of other pending industry transactions that are under Letter of Intent, some of which Tullius Partners is engaged on.

Providing further fuel to our outlook for both the near and long-term future of M&A activity in the facilities services space are the varied types of buyers that are expected to participate in it. While some of the more notable acquirers have yet to restart their acquisition motors, a seemingly unprecedented number of “new” buyers have surfaced. These include both strategic and financial buyers, and count amongst themselves companies that have determined to cross service category lines within the facilities services sector, foreign companies seeking entry into the U.S., and private equity groups looking to deploy portions of their funds into the space. The common denominator amongst these varied buyer types is their appeal to the industry’s resistance to recession, good growth prospects, and high fragmentation, all of which are cited herein.

We expect the force of these “new” buyers to collide with an increasing number of business sellers to enter the market within the coming months and years. This latter trend we see being driven by several factors, including anticipated hikes in the capital gains tax rate, the coming of retirement age of the baby boomer generation, many of which are business owners, the uncertainty surrounding the effects of healthcare reform, and the eye-opening and in many cases humbling experience that this latest recession dealt to quite a number of business owners. We expect these merging trends to perpetuate a very high level of M&A activity for some time to come.

Finally, we cannot write at length about M&A activity in any space without recognizing and addressing the impact that the still tightened credit markets are having and are expected to have in the future. The resurgence we’ve identified in this white paper has come despite, not in support, of the current credit environment. The credit markets remain virtually shut down, specifically with respect to M&A funding. Current transactions are being funded by relatively large amounts of equity, complimented by much lower levels of debt financing. To this end, and an interesting side note on the subject, we have not and did not see noticeably higher percentages of seller financing for industry transactions during the market downturn. While the credit markets figure to loosen as we move further from the depths of the recession, it remains to be seen just how much they will open up. This figures to be a heated topic, with both political and economic overtones, for a few years to come. Having said that, as the credit supply does improve, it will only enhance the already high level of M&A activity that figures to take place.

While M&A trends generally have an ebb and flow to them, we believe that the facilities services industry will see a sustained and perhaps unprecedented level of deal activity in this decade. We further expect the activity to be such that opportunities to capitalize on it will come on both the buying and selling sides.

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