

Newsletter



Acquisition Update

Collapsing banks, Jerome Powell's never-ending battle of interest rates and inflation, and more private equity firms entering the market, 2023 is set to keep things interesting. Starting with the macroeconomic, after spending 2022 increasing rates at a speed not matched since the 80s, the Fed has begun to slow down the rate hikes. In March, the Fed was predicted to raise rates by a half a point, but that was before several major banks failed, rocking financial markets and creating stability concerns that rate increases were about to knock the economy off course. Even amidst a financial crisis, the Fed continued with a quarter point rate increase. While the bank failures are unlike what happened during the 08 crisis, it is important to keep in mind the instability that can ensue when inflation and interest rates soar high and faster than market expectation. Even now, only one of the 11 Fed officials see just one more rate increase coming in 2023. Higher interest rates are working to slow down inflation with consumer prices down more than 3 percentage points from its June peak of 9.1. In response to increased scrutiny and market instability, banks have begun to tighten lending standards across the spectrum of consumer financial products. Powell mentioned in a recent press conference that the credit crunch is likely equivalent to a quarter-point rate hike. Market data suggests that the Fed hikes are likely to slow down, but each increase means higher borrowing costs for consumers such as credit cards, home loans and the likes. These higher borrowing costs are unlikely to fall until interest rates are cut. In the face of these headwinds, we continue to see a healthy amount of acquisition activity from both strategic and private equity players. Pest control has long been thought of as a recession proof business, and this has continued to push money into the sector with thoughts of growth slowing down on investors' minds.



A Pest Control Business, What’s it Worth?

The most popular PCO question we answer at Kemp Anderson Consulting is “what’s my business worth?” Our answer is always “it’s complicated and there are many variables” but let’s look at some popular valuation methods to give you a better idea of what companies are looking at when they determine an offer for any business.

The first valuation method is a percentage of gross annual revenue. When Kemp first started in the pest control industry almost 30 years ago, everyone talked about “dollar for dollar” valuations. That was just an easy way for buyers and sellers to describe the value they were placing on the average business. Buyers use a multiple, or percentage of gross annual revenue, as a way to simplify valuation but it really isn’t an accepted valuation approach. The problem with a revenue multiple is that it is top line, and we all know – all revenue is not the same. As an example, door-to-door pest control companies pay a much higher labor/sales cost and generally have lower customer retention than a traditional operation that focuses exclusively on residential pest related services.

Similarly, service line mix is going to drive other operational differences. Exterior only vs interior/exterior, solid route density vs rural routes, and retention are just a few examples that determine the percentage of overhead costs in relation to gross sales.

Here is where a valuation based on revenue multiple misses the mark, and why we don’t see this valuation method used today; if you had to choose between buying a business doing \$1.5M with \$200K (13.3%) in profit versus a business doing \$1M in revenue with \$400K (40%) in profit, all other things being equal, the second business is going to command a significant premium compared to the first as a result of increased margin and not amount of revenue. If we had only looked at revenue \$1.5M versus \$1M and used a revenue multiple of 2, the first business would be worth \$1.5M*2 = \$3M. The second would be worth \$1M*2 = \$2M. However, the second business makes twice as much profit. A revenue multiple valuation ultimately serves as a gut check when thinking about what your business is worth, and in most cases, we would not recommend signing a LOI or agreeing to professional valuation that is based on a multiple of revenue. In reality, revenue multiple is a conversion of an earnings multiple and not really a valuation multiple. As an example, a company with \$1mm in revenue and \$250k in non-diluted earnings that sells for \$1mm was paid 4x revenue. If they are paid \$2mm they sell for 8x revenue.

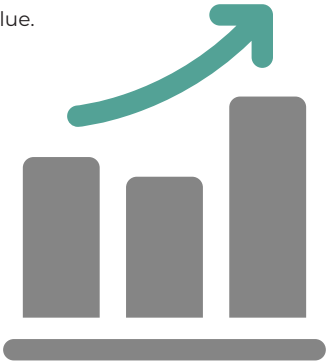
A second valuation method is a multiple of discretionary earnings. Discretionary earnings is also sometimes referred to adjusted cash flow. A simple way to think about discretionary earnings is to quantify the total financial benefit of a company within a 12-month period (TTM trailing twelve months or calendar year). To do this, the buyer looks at the taxable revenue (found on the tax return) and then adds back expenses that the owner benefits from throughout the year. A way to think about this is, what is the business net income or profit when the seller owns the business compared to when a buyer owns the business after close? This will include expenses such as personal cell phones, travel & entertainment, the owner’s vehicle, boats, gas, insurance, and other items that the owner has run through the business but that are not mandatory for day-to-day business operations. Once the business is sold, those expenses would not be assumed by the buyer. Those expenses are additional owner’s compensation that reduces taxable income. Buyers in our industry use a wide range of discretionary earnings multiples, depending on the location, route density, service mix, profitability, employee tenure, and many other factors. In short, benchmarking with a few other owners who have sold their business won’t give you a full picture of what drove the purchase price from a particular buyer. At Kemp Anderson Consulting, we have seen earnings multiples approaching 20x.

The third valuation method is a more sophisticated financial model that takes a lot of variables into account and blends them to come up with a range that the buyer is willing to pay. These models are custom and proprietary to each individual buyer, but they consider many of the same variables that we discussed earlier in this article. **You may be asking yourself how you can move into the upper end of a valuation range.**

- Locating your business in an area with a strong and growing economy adds value. Market and location matter.
- Showing year over year revenue growth as well as increased profitability builds value.
- A clean set of tax returns and consistent bookkeeping practices will bring value
- A strong management and high employee tenure demonstrates the business is poised to grow
- A higher percentage of recurring revenue and less one-time services add value. More predictable and stable cash flow adds value.
- High route density and low callback rates indicate the business is being operated efficiently and will add value.
- Regular annual price increases add value to the buyer
- A high percentage of auto-pay customers adds value to the buyer

What factors will reduce the value of an offer?

- An overreliance on the owner for management will lower the value of the deal.
- High customer turnover will lower the value of the deal
- Low pricing
- High COGS (labor, chemical costs, fleet, fuel) beyond industry norms
- Poor hiring practices (no drug tests, background or driving records checks)
- Allowing drug use. Please remember, marijuana is still against federal law.



Eastside

There’s something special about the pest control industry. Everyday the team at Kemp Anderson Consulting has a chance to learn about someone’s personal success story. Some of those stories span generations and their company history is part of the very fabric that makes our industry what it is today. We recently had the honor of representing a legend in our industry; Eastside Exterminators.

When we talk about legends, this family has more than their fair share. Ralph Townsend Sr., was a pioneer in Washington State’s pest control industry from the early 1940’s. Ralph was among the first three people in the state of Washington to be issued a Pest Control license and helped form the Washington State Pest Control Association (WSPCA), today known as the Washington State Pest Management Association (WSPMA).

Ralph Sr. had three children who all worked with their dad in his pest control business during the summer months and learned about owning and operating a pest control business from a very young age. All three children went on to start and run their own successful pest control companies as adults!

Eastside Exterminators was started by Ralph James (Jim) Townsend Jr. in 1969. Jim and his wife Hazel had 4 children who often worked in the business throughout their childhood. In 1988, their daughter Deanna joined the company full-time. Deanna was a natural and has worked in every aspect of business, inspecting thousands of homes, providing services, managing routes and route technicians, customer service, as well as managing the day-to-day inner workings of the company. Deanna married Alex Altizer in 1990 and eventually Alex came to work at Eastside in 2000, when Jim and Hazel decided it was time to retire. At that time there were 7 employees. Together, Alex and Deanna have grown the company to over 70 employees.

The Company celebrated their 50th anniversary in 2019 and in 2022 Alex and Deanna partnered with Anticimex to create a transition plan for the organization.



“Pest control is a little different in the Seattle market due to our unique geography and weather conditions. The team at Kemp Anderson Consulting worked with us to understand these nuances, positioned us correctly to potential buyers, and negotiated a great purchase price. We were unprepared for the long, complicated process of getting the deal closed but this team stayed with us every step of the way and had the knowledge, experience, and relationships to get us over the finish line.”

- Deanna Townsend
Co-Owner of Eastside Exterminators

Private Equity & Pest Control

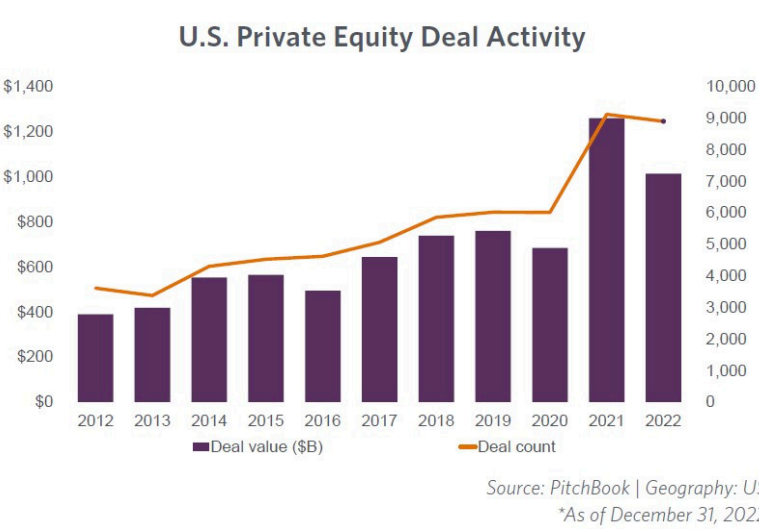
What is Private Equity and Why is there a focus or interest in Pest Control?

When people say PE or “private equity”, they are generally referring to a firm that aggregates or collects investors capital and deploys it in private investment opportunities. The GP’s (general partners) collect capital from institutions and high net worth individuals, who are called LP’s (Limited Partners). The LP’s or investors provide money for the firm to invest. Most funds are structured to operate for 5-to-10-years. It is common for the first few years to be spent researching an industry and making an initial investment (buying a business in that industry). The initial investment is usually large and called a “platform”. Typically, a firm spends the next few years operating the new business, growing it, and then the last few years they are focused on exiting (or selling) the business and returning a profit to their investors.

Private equity firms are nothing new in Pest Control industry, nor are their financial tactics. Starting with Wayne Huizenga the previous owner of the Miami Dolphins, Florida Panthers, and Florida Marlins. Huizenga is credited with what we now call “roll ups”. He began in the waste industry by buying a series of garbage companies and aggregating them into what is now Waste Management Inc. For those of us that remember VHF tapes, he did the same with Blockbuster. Unlike the investment icons of 80’s such as Carl Icahn, who made their money buying conglomerates and selling of their pieces, the roll-ups starting in the 90s are the reverse of a leverage buyout, because they leverage equity and access to debt markets to finance the aggregation of businesses. Mr. Huizenga combined or acquired businesses to form empires in sports, waste, and media.

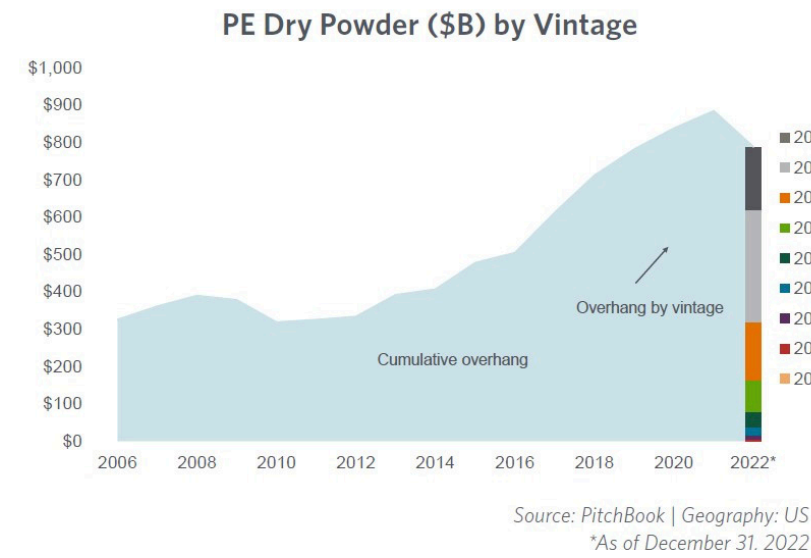
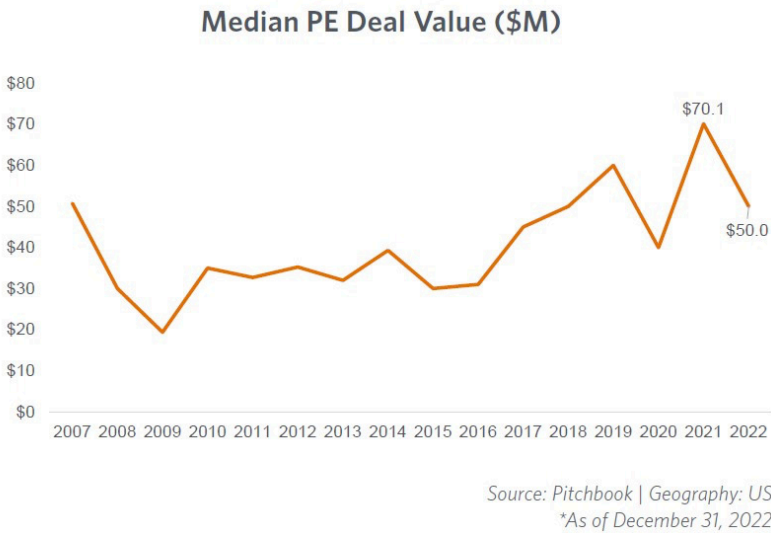
Since the 90’s, we have seen hundreds of roll ups across industries from banking, funeral homes, pet cremation, bus lines, car wash, medical services, and pest control. PE firms can capture market share because these industries are highly fragmented. In the early 2000s, Royal Palm (PE firm) entered the pest control industry by purchasing Middleton Lawn and Pest Control in Florida. At the time, Middleton was generating an estimated 8 million a year in revenue.

The plan, according to Kemp Anderson, who singlehandedly led the acquisition frenzy at Middleton for Royal Palm, was to go public. “After closing the platform acquisition (Middleton), we took control of a failing penny stock: SNE (Sun Air Electronics). Selling their core electronic assets, we rebranded the SNE business as pest related services business and proceeded to close at least one deal per month. The heavy acquisition activity at a lower P/E (price to earnings) multiple created an arbitrage opportunity. We did an initial offering around \$2.00 a share and drove the stock to approximately \$12 a share.” After a few years, the assets were sold for over \$50 million.



Usually, these firms are smaller, and the deals are negotiated off market and outside of an auction process where a firm could maximize value at the point of sale. These cheaper deals dilute the higher cost of the initial platform investment. With more firms entering the market, competition for deals get higher, increasing the transaction multiples at which deal are performed.

The second factor contributing to the efficacy of the private equity strategy is the availability of a profitable exit strategy. As discussed above, PE firms deploy capital by buying and aggregating (collecting and combining) various businesses. The rise in interest rates has had a clear negative effect on the PE industry; we saw a sharp decline in the volume of deals in the second half of 2022. Since PE firms tend to use debt to finance part of their investment, higher rates are squeezing the margin on deals. The good news for PE firms is that major strategic players in the market are still trading at record high price-to-earnings multiples, suggesting there is still an opportunity sell a premium asset at a high price.



PCO’s should keep in mind the observations from Cherry Bekaert, “From 2021 to 2022, total private equity capital raised dropped almost \$20 billion year-over-year according to Pitchbook’s 2022 Annual US PE Breakdown. Declines in public equity markets may mean many LPs are either fully allocated or over allocated to the alternative investment asset class. Given these dynamics, it is not surprising to see the duration to close a new fund ticked up to 15.4 months from the 13.8-month average seen in 2021. On the other hand, the average time between funds continues to tick lower and reached 3.0 years in 2022, down from 3.2 years in 2021.”

PCO Perspective:

If you are a pest control operator, here are some things to keep in mind.

1. PE firms are incentivized to negotiate outside of a formal auction process. Less competition generally means a better price and terms for the buyer. Don’t be surprised if PE firms are reaching out via LinkedIn or other methods to ask for a meeting. PE Firms prefer to meet and buy PCO’s that are alone and not represented.
2. Private equity firms are in one way or another beholden to their investors, and these investors want to see a return on their investment. To see a return on their capital, a firm needs to monetize their newly created asset, while holding times (how long a firm will hold onto the asset, aggregated companies in this case) has increased to a little over 5 years, it should be no surprise that your company and team will almost always go through a second sale farther down the line. Some firms are rumored to be going public, but this the exception more than the rule.
3. A large portion of the leadership teams tends to be tied up in common equity or stocks options, usually behind the private equity firm’s ownership in payout. It is critical to understand the terms of any options or restrictions on equity in a deal that you make, because they can substantially impact the value of the leaderships team’s equity.

Private equity firms can be great for companies whose owners want to seek aggressive growth strategies and big change ups. Generally, for platforms, we see the buyer offer a large percentage of the transaction in cash up front with a complete ownership transfer with the potential for a second bite of the apple if you are willing to stay on and steer the company successfully.

Advantages of Selling to a Private Equity Firm:

1. Private equity firms can be willing to use creative financial structures to reward owners who are willing to stay on and continue to grow the business.
2. Private equity firms looking to get into the industry can be willing to pay a high premium to make their initial investment.
3. Some business partners desire to remain partial investors, shedding off some managerial roles. They become rollover investors.
4. The business lacks the financial muscle and stamina to finance growth and expansion. It requires an external capital injection to oil its business growth.
5. PE Firms typically have abundant resources including cash to support the business.

When engaging with a PE firm who is interested in your business, here are some questions to keep in mind:

1. How many investments have you made in your fund?
2. How many investments are you intending to make in your fund?
3. How do you structure capital?
4. Do you use preferred equity or any types of debt?
5. After close, what decisions are delegated to the board versus the business leadership team?
6. What percentage of your last LOI’s (letters of intent) have closed?
7. Can you explain why any of your past deals didn’t close?
8. If I hold a note (or paper) what are my guarantees to be paid in full?
- 9.9) How long will you (the PE Firm) hold my company before it is sold again as part of a larger entity?

PE firms are viable buyers for our industry, and while the macroeconomic environment may be pulling down the parameters that make investments profitable, the additional competition and deal creativity offer sellers additional paths and opportunities when it is time to sell. As a seller, it is important to remember that private equity firms operate differently than traditional industry buyers, and whether you are selling to a regional, national, international, or private equity firm you should do extensive research on potential candidate and you should consider hiring experienced support to help get you through the selling process. Odds are your pest control company is your largest asset and the transaction process can be complicated.

5 Critical Steps to a Successful Transaction

A mergers and acquisition consultant is absolutely critical.

And I'm not just saying that because that's our area of expertise. Most people have never sold a business before; selling your greatest asset is not the time to learn through trial and error. An M&A consultant should help you prepare to sell. As such, this person or team should know the pest management industry and your business inside and out in order to add value to you as you begin to prepare to exit while positioning your enterprise in its best light, taking time on the front end prior to going to market. However, it will pay large dividends as this work will help you and your family achieve a premium for your company. Skipping this step and not making this critical hire can literally cost millions of dollars in value as the offers for your company come in.

A specialized acquisition attorney is key to the process.

Simply put, attorneys who specialize in M&A know what to focus on in an acquisition and will not waste everyone's time and your money focusing on silly things like font size or formatting or, worse yet, simply making a material error an experienced M&A attorney would not. A specialized acquisition attorney will make the process smoother and efficient for all involved while advocating for you, your family and the company that you built and are selling. A specialized M&A attorney is crucial.

CPAs are critical in this process.

CPAs are critical in this process. Some business owners do their accounting themselves or use bookkeepers. If owners or bookkeepers make mistakes in their work, it can be extremely costly as you exit your business. We believe it is critical to have high-caliber CPAs involved in this critical decision prior to selling and certainly post transaction to minimize exposure. Non-pest management industry CPAs and bookkeepers should not drive your acquisition process as service industries like ours are typically not their specialization.

Wealth management firms.

Wealth management, family trust, and other critical family and life decisions should be considered as well as wealth management firms and estate attorneys (which is typically different from an M&A attorney) as you move to the end of the selling process. Typically, these transactions create more wealth than most people have ever dealt with in their life and as a result, having a professional team including, but not limited to, a wealth manager and estate planning specialist is the key piece to your team.

Go to market.

Ultimately, when the business is completely prepared to go to market, you go; however, starting the process before you and the business are prepared is a costly mistake that should be avoided. At this point in the process, your team should be in place and ready for the frantic months ahead. This will ideally include multiple buyers and multiple offers as a result of the preparation and work, and the right team will be ready for due diligence, legal work, schedules and exhibits, and onboarding in integration that sellers should plan to support.

After meeting with multiple buyers, and reviewing multiple offers, you choose your offer (price and terms are critical), you choose your buyer and you execute. Choosing the offer and buyer often comes down to price, terms, and a fit between the buyers and sellers' cultures, merging what both value and believe in as business principles.



“Kemp Anderson Consulting was an amazing resource during the sale of our company. They helped us maximize our valuation far beyond expectations. They were professional, responsive, and worked very hard to navigate a very complex and difficult transaction. We were very blessed to not only achieve great results, but to make new lifelong friends along the way!”

- Todd Lamar
Owner of Pest & Termite Consultant

Rentokil Terminix acquires Exodus Exterminating

Reading, Pa. – Rentokil Terminix announced the acquisition of Exodus Exterminating, a Rochester, N.Y.-based pest management company.

“We are excited to have the Exodus Exterminating team join the Rentokil Terminix family,” said John Myers, president and CEO of U.S. Pest Control for Rentokil Terminix. “We look forward to continuing their high-quality service with a shared mission of providing ‘people-first’ pest control services for all customers.”

Exodus Exterminating has served the greater Rochester, N.Y., community with commercial and residential pest management services since 1984.



“We are extremely happy with our choice to have Kemp Anderson Consulting represent us in the sale of our business. Kemp Anderson Consulting operates with a very high level of professionalism, competence, and thoughtful communication. Their ability and willingness to help us understand the process, from beginning to end, was very important to us. There are some things you can do yourself, but navigating the sale of your life's work is not one of them. I highly recommend Kemp and his Team.”

- Dale Larnder
Co-Owner of Exodus Exterminating, Inc.



“We are forever grateful to Kemp Anderson Consulting for guiding us through one of the biggest decisions of our life. When we decided it was time to sell, we could not imagine a better team to represent us as Kemp Anderson Consulting. They came highly recommended from many respected people in the industry, and were very helpful educating us on understanding the process, and guiding us every step of the way. We feel blessed to have Kemp Anderson Consulting represent us and are extremely satisfied with the results.”

- Gary Kozlowski
Co-Owner of Exodus Exterminating, Inc.

Rentokil Terminix Acquires Dixon Pest Services

Reading, Pa. – Rentokil Terminix announced the acquisition of Dixon Pest Services, headquartered in Thomasville, Ga.

“Since 1964, Dixon Pest Services has been dedicated to protecting people, and enhancing lives through their pest management services,” said John Myers, President and CEO of U.S. Pest Control for Rentokil Terminix. “We are excited to welcome the customers and colleagues of Dixon Pest Services into the Rentokil Terminix family, and we look forward to continuing their high-quality service in the Georgia and Florida regions.”

Dixon Pest Services was founded in 1964. The company provides residents and businesses in the southwest Georgia and northeast Florida regions with termite and pest management services.



“When I decided to investigate selling my business, I did my due diligence. I investigated Kemp's references and did my best to verify what I was being told. Based on my investigation and my conversations with Kemp, I choose Kemp and his team. Kemp told me he would represent me and my family to the best of his abilities and we would be friends upon completion of the deal. He held up his end of the deal. Kemp and the team were there to help me at every step in the journey and his advice and counsel were invaluable to me. I am highly satisfied with the results of the sale of my business and would highly recommend Kemp and his team to anyone considering selling their business.”

- Charles Dixon
Owner of Dixon Pest Services

5 QUESTIONS WITH Kemp Anderson

1. What's Going on with Interest Rates?

There is a tug of war between increasing prices (inflation) and the Federal Reserve - the controller of interest rates in the US. The Federal Reserve's mission is to keep the U.S economy running at that goldilocks temperature. When the economy run too "hot", market distortions like inflation and the asset bubbles can arise. Too "cold" and we can enter periods of economic recession with GDP growth and investments declining.

2. How Does the Fed Change Rates?

Generally, the fed changes the interest rate on reserve balances. This is the interest rate that banks hold their reserve balance accounts at the Federal Reserve. Since the Fed is paying higher interest to financial institutions on reserve balances, short term interest rates are lifted to match this risk-free opportunity.

3. How Does Higher Rates Effect my Business?

Higher interest rates increase the cost of credit throughout the economy, meaning loans and other credit products get more expensive for businesses and consumers. Depending on how you purchase fleet or inventory, it is important to understand the terms of those agreements, as you may be paying more than you were in a low-rate environment.

4. How Does this Impact Acquisitions?

As interest rates rise, the future value of a dollar goes down. Said differently, it costs more to borrow and finance deals. Gone are the days of the cheap debt and with greater scrutiny on our financial institutions after the collapse of several banks, credit is going to be harder and more expensive to find. The good news is a large portion of strategic buyers don't rely on heavy debt financing, and private equity firms are still sitting on a substantial amount of cash that they raised in more relaxed macroeconomic environments. In the years to come, multiples may start to get squeezed.

5. Do Interest Rates Affect Private Equity Activity?

Private Equity firms are impacted by rising rates in some instances because of their reliance on debt to fund portions of acquisitions. As the Fed raises rates, the cost of debt gets higher, which increases the cost of purchasing a company using debt. PE firms have already raised a substantial amount of capital in a low-rate interest rate environment that they will need to deploy in the years to come. It will be interesting to watch how transactions are structured in a world where debt is no longer cheap. We expect to see an increased reliance on equity roll over by owners and a push for owners to hold larger notes.



MEET GRANT SINNOTT

Grant Sinnot is a quantitative analyst and data scientist. He holds a BA in Mathematics and Economics and an MBA in Finance from the University of Florida. For more than 6 years Grant was responsible for quantitative analytics at Bank of America. He participated in macro economic and credit modeling for various bank portfolios. His background in software engineering, data science, and financial engineering is a true value-add to our clients as they evaluate their selling potential.



RELATIONSHIPS:

With over 20 years in Pest Control mergers and acquisitions, I maintain relationships that benefit our clients with qualified buyers, CPA's, specialized M&A attorney's, wealth management, and more.

RESULTS:

Our clients only have one chance to exit their life's work, so it's critical that we get it right the first time. Kemp Anderson Consulting has a long, proven, track record of achieving both high revenue and earnings multiples for our clients.

KNOWLEDGE:

I've spent over half my career representing some of the top buyers in our industry and I'm able to leverage that unique expertise for our clients from pre-sale preparation work to close and beyond. There is no other industry consultant, broker or investment banker with similar qualifications.

COMBINED FIRM EXPERIENCE

- Over 35 years of combined industry experience in the firm
- Master's degrees in Business, Entrepreneurship, and Finance
- Representing some of the most prominent owners and company's in our industry
- Data Science Expertise

REFERENCES:

Don't just take my word for it. We can connect you with other clients so that you can determine the best fit for you, your family and your business.

KEMP ANDERSON

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emp Anderson is a veteran in the pest control industry. In 1995, he started his career at Sears Termite & Pest Control in branch operations.

He later started his own pest control company, which he sold to Terminix. He transitioned to Middleton Lawn & Pest Control as the director of business development and manager of legal affairs before moving on to Rollins as its director of acquisitions. His success in expanding organizations through mergers and acquisitions, both in North America and overseas, led to an opportunity as the vice president of business development at Scotts Lawn Service, where his responsibilities included leading all mergers and acquisitions activity, developing new service lines, growing existing service lines and expanding the franchise operations to include new service offerings in new locations. Anderson has a degree in political science from Rollins College and an MBA in finance and operations management from The Roy E. Crummer Graduate School of Business.

Company: Kemp Anderson Consulting

Company Bio: Kemp Anderson Consulting is a fiduciary and expert in the field. They help owners find the right buyer and get the maximum purchase price when selling.

Years in Business: 8

More Info: kempanderson.com, 407-466-5859

**KEMP
ANDERSON
CONSULTING**