

BAIRD'S PERSPECTIVE ON THE
HVAC SPACE

Climate Technology Report



BAIRD

Global Investment
Banking



Favorable Climate Tech market dynamics are driving M&A activity

M&A momentum in the climate technology sector should continue for an extended period

- Increased interest in the sector is translating to a surge in transaction activity
 - Over the past year, deal count and deal value were about 70% above average annual figures pre-COVID
 - The entire value chain has seen substantial growth in M&A, including the equipment, components, distribution, and services segments
- Strategic acquirors are pursuing premium climate tech assets that provide innovative products, new technology and solutions capabilities, broader geographic coverage, and expanded channel relationships
- Financial sponsors also are active acquirors due to an ample supply of targets providing platforms for consolidation in large addressable markets

Acquirors are focusing on climate tech due to strong market fundamentals and an extensive range of M&A drivers

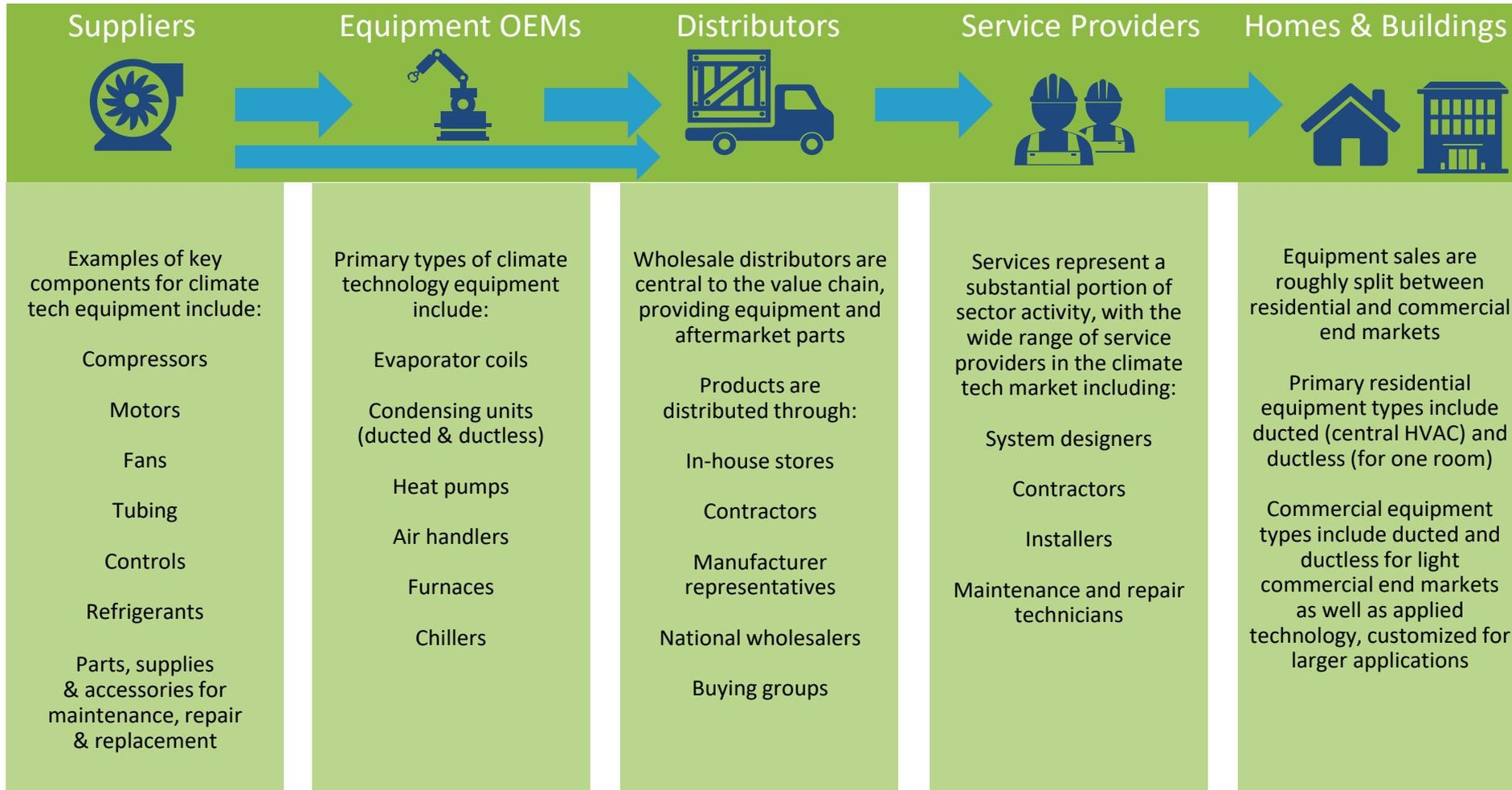
- Fragmentation across products, distribution, and services segments
- Increased public company and M&A valuations over recent years
- Powerful secular themes, led by implementation of indoor air quality technologies in commercial and residential markets
- Recession resilience due to the large, steadily growing repair and replacement business

Climate tech market is well positioned for solid longer-term growth

- Strong growth to date in 2021 reflects the residential market's rebound from the impact of COVID, while projections for healthy growth in 2022 incorporate expectations of a commercial end market recovery
- Replacement and repair activity for the expanding and aging equipment base provides a solid foundation for long-term growth
 - Remote working during COVID sharpened focus on investing in the home and added wear on aging HVAC systems
 - The commercial market features large recurring revenue streams for aftermarket products and services amid the 20+ year replacement cycle
- Additional drivers poised to fuel sustained growth include greater focus on indoor air quality (IAQ), energy efficiency, and digitalization, with these powering replacement unit sales and creating a significant retrofit opportunity across residential and commercial end markets
- Heightened emphasis on IAQ should support incremental demand in the sector for a lengthy period
 - COVID underscored the need for a healthy, safe, and sustainable indoor air environment, as people spend most of their time indoors
 - Increased awareness of IAQ is stimulating demand for products and solutions that reduce mold, allergens, and airborne viruses

CLIMATE TECH MARKET OVERVIEW

Value chain includes OEMs, suppliers, distributors, and service providers



CLIMATE TECH M&A OVERVIEW

Recent M&A activity has increased amid strong interest in the sector

Large Growth in Recent Deal Count

Average M&A deal count of 74 in 2015-2019 **+77%** 131 M&A deals in last 4 quarters

- Analysis of M&A activity across the climate tech sector reveals hefty growth in the past four completed quarters through Q3 2021 following a pause in the M&A markets during 2020 due to COVID
- Momentum carried through Q2-Q3 2021, which posted the highest two-quarter deal count in our data set

Expansion in Recent Deal Value

Mean disclosed value of \$4.4b in 2015-2019 **+67%** Disclosed value of \$7.3b in last 4 quarters

- Increased interest in the sector is also evident in the higher level of disclosed deal value of the past year, including seven deals with disclosed values exceeding \$250 million since last November
- The aggregate value for M&A in the sector is meaningfully larger than the disclosed level, as deal values were undisclosed for 89% of transactions in the last four quarters

M&A Growth Across Value Chain

Mean services deal count of 39 in 2015-2019 **+84%** 72 services deals in last 4 quarters

- M&A activity over the past four quarters within each segment of the climate tech value chain – equipment, components, distribution, and services – was at least 50% above the average for the 2015-2019 period
- Recent growth in M&A deal count was highest in the services segment, which generally accounts for a slight majority of overall activity in the sector

M&A Drivers



MARKET FRAGMENTATION A LEADING M&A DRIVER

Significant M&A runway in climate tech sector due to consolidation opportunities



Components

- Consolidation opportunities are significant in many product categories, particularly for OEM and aftermarket component suppliers
- Fragmentation among component suppliers contributed strongly to the 150+ M&A transactions that we tracked in product segments since the start of 2015
- M&A activity has been more frequent in component categories than for equipment, where market share in certain segments is relatively concentrated among leading OEMs

Frequent Components Acquirors



Distribution

- The climate tech product distribution segment is highly fragmented, with leading distributor Ferguson estimating that competitors with less than 1% share comprise 70% of the U.S. market on a combined basis
- 95%+ of the estimated 2,000+ independent distributors in the U.S. have annual revenue below \$100 million
- Industry leader Watsco has more than twice the market share of its closest U.S. competitor, helped by a combination of organic growth and eight acquisitions over the past five years

Frequent Acquirors in Recent Years



Services

- Fragmentation in the services segment is enhanced by the extensive range of services involved, including custom system design, installation, maintenance, repair, and replacement services
- As evidence of the consolidation opportunities in this category, services represented slightly over half of M&A transactions in climate tech since 2015
- The services segment experienced faster growth in M&A activity during recent quarters than in the products and distribution categories

Frequent Acquirors in Recent Years



Premium climate tech assets are drawing substantial interest

Strategic Rationale	Benefits for Acquirors
<p>Bringing track record of innovation and R&D geared toward secular trends</p>	<ul style="list-style-type: none"> • Strengthening technical expertise to develop solutions satisfying more stringent requirements for air quality and energy efficiency • Improving sustainability given rising ESG focus – e.g., leading OEM Trane has committed to cutting 1 gigaton from customers’ CO2e footprint by 2030
<p>Adding capabilities</p>	<ul style="list-style-type: none"> • Integrating technology that enables acquirors to capitalize on growing adoption of indoor air quality solutions • Given increased demand for indoor air quality solutions, market participants are pursuing an extensive range of air purification technologies
<p>Enhancing product range and applications</p>	<ul style="list-style-type: none"> • Facilitating cross-selling of products / services with high attachment rates and recurring revenue characteristics • Adding digital features that promote higher efficiency, security, and serviceability
<p>Expanding geographic presence and channel relationships</p>	<ul style="list-style-type: none"> • Increasing total addressable market • Gaining new channel relationships • Broadening operational flexibility and diversifying supply chain
<p>Providing platform for consolidating large, fragmented market</p>	<ul style="list-style-type: none"> • ‘Buying’ often beats ‘building’ in efforts to gain market share efficiently • Appealing to financial sponsors looking to invest in the sector, which is early in its consolidation phase
<p>Capturing recurring repair and replacement demand</p>	<ul style="list-style-type: none"> • High level of non-discretionary demand • About 80% of new residential ducted units replace existing units (92+ million in U.S.) • Recurring revenue opportunity is growing given expanding installed base in residential and commercial end markets

SELECTED RECENT CLIMATE TECH M&A TRANSACTIONS

Financial sponsors are showing significant interest in climate tech platforms

Date	Target	Acquirer	Target Description
September 2021	 HealthWay	 ae Industrial Partners	Provider of innovative air purification technology solutions for mission-critical environments
August 2021	 Reedy INDUSTRIES	 Partners Group REALIZING POTENTIAL IN PRIVATE MARKETS	Provider of HVAC and mechanical services primarily to large manufacturing and industrial plants
August 2021	 WITTICHEN SUPPLY COMPANY	 CEYRON CAPITAL	Distributor of HVAC and refrigeration parts, equipment, and supplies to contractors in the Southeastern U.S.
June 2021	 GIL-BAR	 ICG	Provider of custom commercial HVAC solutions in the Northeastern U.S.
May 2021	 Travis Perkins (Plumbing & Heating business)	 H. I. G. CAPITAL	Distributor of plumbing, heating, and bathroom products in the U.K.
April 2021	 Zone Network LLC	 TJM Capital Partners	Provider of refrigeration and HVAC services to commercial and industrial customers in the Midwestern U.S.
December 2020	 Right Time GROUP OF COMPANIES	 CEYRON CAPITAL	Provider of HVAC services to the Canadian residential replacement market
December 2020	 HEARTLAND HOME SERVICES	 THE JORDAN COMPANY	Provider of residential HVAC, plumbing, electrical, and indoor air quality services in the Midwestern U.S.
November 2020	 THERMA	 Blackstone	Provider of HVAC, mechanical, electrical, and plumbing services focused on commercial and industrial markets
September 2020	 HART COOLEY	 H. I. G. CAPITAL	Manufacturer of HVAC and air distribution products, including vents, grilles, registers, diffusers, and rooftop and chimney products
September 2020	 ARS RESCUE ROOTER Making it work. Making it right.	 Charlesbank	Provider of air conditioning, heating, indoor air quality, plumbing, drain cleaning, and sewer line services for residential and light commercial markets
February 2020	 nsi INDUSTRIES	 ODYSSEY POWER	Supplier of electrical connector, fitting, control, and wire management products for construction, maintenance and repair applications, including HVAC
January 2020	 ASPEN PUMPS GROUP	 inflexion	Supplier of condensate removal pumps and related products to HVAC markets in Europe and the U.S.

SELECTED RECENT CLIMATE TECH M&A TRANSACTIONS

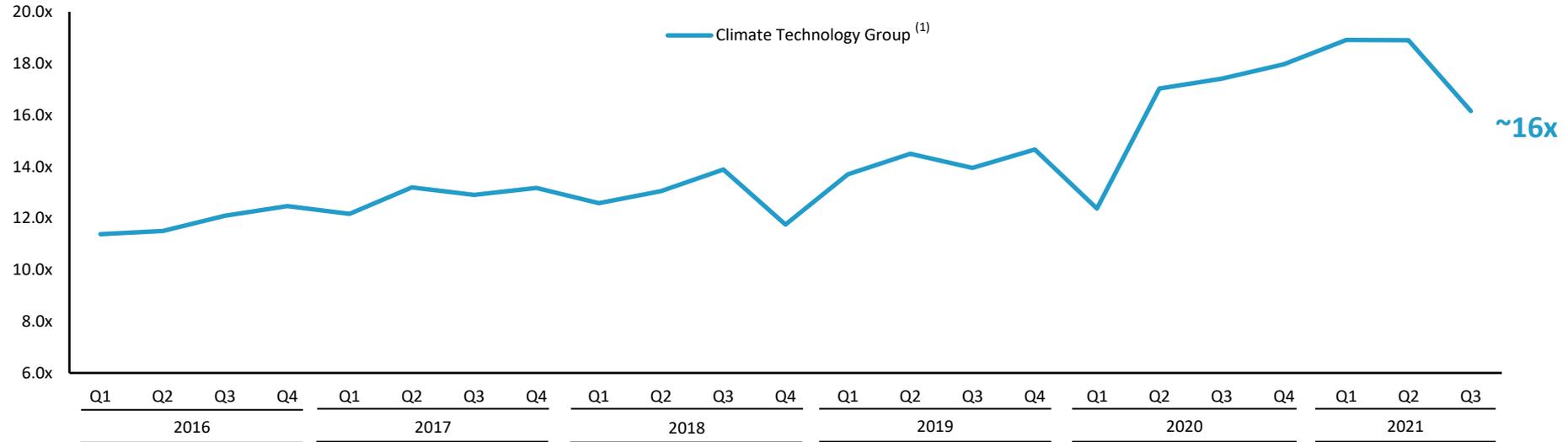
Strategics have been increasingly active acquirors in the climate tech space

Date	Target	Acquiror	Target Description
September 2021	 PROTECT PLUS AIR	 FREUDENBERG INNOVATING TOGETHER	Designer and provider of residential filtration solutions that enhance indoor air quality and HVAC performance
September 2021	 AIRXCEL	 THOR Go Everywhere. Stay Anywhere.	Manufacturer of HVAC systems and appliances for RV markets
June 2021	 molecular	 Filtration Group Making the World Safer, Healthier & More Productive	Provider of consumable air purification media for life critical applications in medical, defense, and industrial markets
July 2021	 FRIEDRICH	 Rheem	Manufacturer of air conditioners for residential and commercial markets
April 2021	 NORTEK	 MADISON INDUSTRIES	Provider of critical air management, thermal, and HVAC solutions across broad commercial, residential, and data center markets.
March 2021	 FRESH-AIRE UV	 DIVERSITECH	Manufacturer of UV-C disinfecting light and carbon odor control products for commercial and residential HVACR systems
March 2021	 Packard Sustaining HVAC systems all year round.	 DIVERSITECH	Distributor of electrical components to the HVACR industry
December 2020	 HART COOLEY (Flexible Duct Business)	 MUELLER INDUSTRIES	Manufacturer of insulated and uninsulated flexible ducts for residential and commercial applications
December 2020	 METAL INDUSTRIES	 GREENHECK	Manufacturer of air handling products, including grilles, registers, diffusers, louvers, and dampers for the residential, commercial, and multi-unit residential markets
November 2020	 TRUaire REGISTERS & GRILLES	 CSW INDUSTRIALS	Manufacturer of passive air handling products, including grilles, registers, and diffusers for the residential and commercial markets
November 2020	 7 A C T E C H	 EMERSON	Manufacturer of membrane-based liquid desiccant technology that manages humidity and temperature in a single step for commercial markets
November 2020	 STEVENS EQUIPMENT SUPPLY	 DAIKIN	Distributor of equipment, accessories, and parts to residential and light commercial HVAC applications in the Midwestern and Southern U.S.
October 2020	 STERIL-AIRE	 MADISON INDUSTRIES	Manufacturer of high energy germicidal UVC solutions for hospitals, schools, nursing homes, airports, laboratories, government facilities, offices, and food safety markets

PUBLIC MARKET VALUATIONS SUPPORTING M&A

Public company multiples have expanded and are near 10-year highs

EV / NTM EBITDA Multiples Over Time



EV / NTM EBITDA Multiples



Source: Capital IQ as of September 30, 2021.

(1) Climate Technology Group includes AAON, Carrier, Daikin, Johnson Controls, Lennox, Trane and Watsco.

(2) Represents EV / NTM EBITDA multiple average since April 2020 IPO.

(3) Represents EV / NTM EBITDA multiple average since March 2020 completion of separation transaction.

We expect significant growth in future years after an OEM-led rebound in 2021

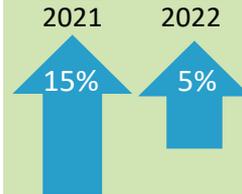
Historical Growth



2014-2019 HVAC revenue CAGR for Trane, Carrier, Lennox & AAON

- Market leaders generated growth averaging in the mid-single-digits in the six years through 2019, preceding the impact of COVID in 2020
- Although slower in 2019, growth continued to be powered by the combination of repair and replacement activity – representing ~75% of total unit sales across end markets – as well as new construction growth in the residential and commercial markets
- Attractive growth rates in the HVAC segment have become more apparent to capital markets participants with Carrier and Trane becoming standalone public companies in early 2020

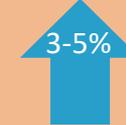
Near-Term Growth



HVAC revenue growth for Trane, Carrier, Lennox & AAON

- Projections for mid-teens growth in 2021 reflect a strong recovery from 2020, when the negative effects of COVID resulted in a 3% decline in the group's revenue
- 2021 forecasts have had an upward bias, rising substantially after the Q2 reporting cycle
- Leading OEM Trane cited focus on indoor air quality as boosting its U.S. commercial revenue by 2% this year
- Healthy growth averaging 5% is currently expected for market leaders in 2022, when the commercial segment could participate more fully in the market's rebound

Long-Term Growth



Projected long-term growth in the climate tech sector

- Beyond next year, we anticipate market growth in the low-to-mid-single-digits for an extended period
- Leading OEM Carrier has noted expecting mid-single-digit growth through the medium term
- Drivers poised to fuel growth: indoor air quality technology, energy efficiency, and digitalization, with these powering replacement unit sales and creating a significant retrofit opportunity across residential and commercial end markets
- Greater uptake in emerging markets over the long term will benefit all segments, including HVAC systems, components, aftermarket parts, distribution, and services

DRIVERS OF CLIMATE TECH MARKET GROWTH

Strong tailwinds should power sustained growth



Replacement & Repair

- In the residential segment, the growing and aging installed base drives recurring maintenance, repair, and replacement activity given 10-15 year replacement cycles, with replacements driving ~80% of unit sales
- Working remotely during COVID sharpened focus on investing in the home, while added wear on HVAC systems due to greater usage is driving more replacement and repair work
- For the commercial market, the 20-30 year replacement cycle provides opportunities to build up recurring revenue streams for aftermarket products and services



Commercial IAQ

- COVID has accelerated the adoption of “WELL Building” initiatives focused on better indoor air quality (IAQ) given increased focus on the safety of tenants, workers, and customers
- IAQ testing and installed base diagnosis are areas of focus driving the adoption of smart HVAC systems interacting with the building automation systems that are increasingly being implemented
- Benefits from HVAC digitalization include energy efficiency, lower operating costs, reduced downtime risk, and increased safety



Residential IAQ

- Due to COVID, homeowners are more aware of the importance of air quality, raising their willingness to upgrade HVAC systems to include IAQ solutions
- Building codes related to fresh air systems and whole home ventilation create significant revenue potential and are increasingly in focus for builders, contractors, and consumers in new construction and renovations
- An estimated 55% of new single-family and low-rise multi-family housing starts include whole home ventilation



Energy Efficiency

- Governments at all levels are implementing stricter regulations around energy efficiency and sustainability, driving replacements and retrofits of older units, as HVAC systems account for 30% of commercial building energy usage
- Regional SEER standard increases set to take hold in 2023 require cooling systems and air-source heat pumps to operate more efficiently
- Innovation in ductless mini-split technology – which connects an outdoor condensing unit directly to indoor air handling units – is addressing stricter regulatory requirements and increased demand for energy efficient products

INDOOR AIR QUALITY (IAQ) OVERVIEW

Heightened emphasis on IAQ is creating incremental demand in the sector

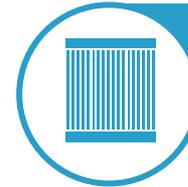
Indoor Air Quality Awareness



IAQ Awareness Driving Demand

- COVID underscored the need for a healthy, safe, and sustainable indoor air environment, as people spend most of their time indoors
- Increased awareness of IAQ and the hazards of poor air circulation are stimulating demand for products and solutions that reduce the risk of transmission through aerosolized particles
- Separately from COVID, interest is rising in IAQ products and solutions that mitigate issues such as allergies and mold
- Manufacturers are focused on developing and upgrading a wide range of air purification technologies given enhanced demand
- Services providers are gaining expertise in implementing air purification technologies

Air Purification Technologies



Mechanical Filtration

Media with porous structures of fibers or stretched membrane material to remove particles from airstreams, often with static electrical charge applied to media



Electric Filtration

Removal of particles occurs by electrically charging particles using corona wires or by generating ions and collecting particles on oppositely charged plates



UV

Ultraviolet energy inactivates viral, bacterial, and fungal organisms so they are unable to replicate and potentially cause disease



Ionization

Various technologies used to create reactive ions in air that react with airborne contaminants, including viruses

ATTRIBUTES OF MARKET LEADERS

Leading players are well positioned to capitalize on market dynamics

Strengths of Market Leaders

Innovative Products & Technologies

Application Expertise

Breadth of Solutions

Customer & Channel Relationships

National / Global Presence

Market Theme

Energy Efficiency

New products reflecting technology advancements help customers meet increasingly stringent regulations related to efficiency and emissions

Indoor Air Quality

Comprehensive offering of IAQ solutions is beneficial given the wide range of air purification technologies

Robust Repair/Replacement Cycle

Suppliers, distributors, contractors, and service providers address recurring demand to maintain / upgrade systems

Digitalization and Connectedness

Ability to develop and maintain systems on a global basis for commercial customers is gaining importance in view of trends toward connectedness

Selected Leading Companies



RESIDENTIAL MARKET SUMMARY

Residential demand has surged amid greater consumer focus on at-home lifestyles

N.A. Residential AC Unit Growth

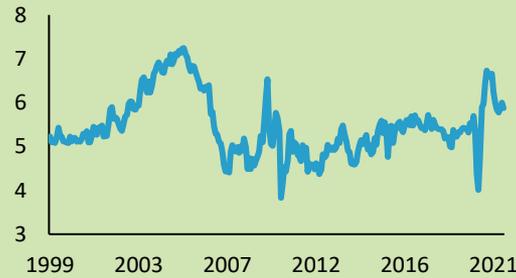
YoY Change for Last 3 Months



- Industry data for recent months indicates strong growth for unit shipments as well as distributor sell-out, reflecting high levels of end market demand
- While early 2021 growth benefited from low year-ago comparisons caused by COVID, the latest data also represents meaningful expansion from 2019 figures
- Added focus on energy efficiency drives demand for new units in existing homes given 10-15 year replacement cycles for the growing and aging installed base
- Phase-out of R22 refrigerant is enhancing replacement and upgrade activity

U.S. Residential Home Sales

Existing Homes Sold (in millions)



- A substantial portion of residential HVAC replacement activity is estimated to be related to the sale of existing homes
- Sales of existing and new homes have surged despite limits on supply amid extreme demand after initial weakness in the early stages of COVID
- Tailwinds include historically low mortgage rates and increased consumer focus on enhancing at-home lifestyles
- Demographics and structural trends are expected to support growth in single-family housing, which requires standalone HVAC systems

U.S. Remodeling Spending Growth

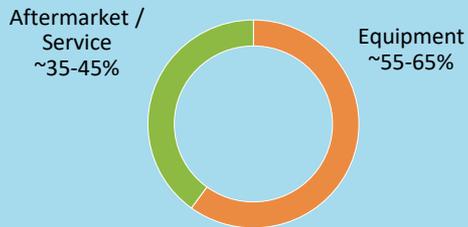
YoY Change for Last 12 Months



- Remodeling activity is rising, with growth expected to accelerate further into 2022 due to increased investment amid “home as a sanctuary” trends
- Aging installed base of HVAC equipment supports demand for retrofit spending from non-discretionary upgrades and remodel activity, which increasingly feature IAQ solutions
- Greater focus on energy efficiency is causing homeowners to include HVAC upgrades in broader remodeling projects

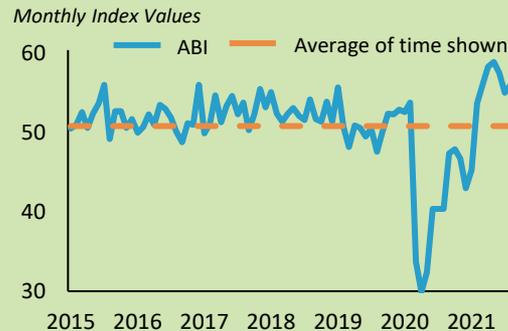
Demand is set to improve given elevated interest in indoor air quality

Commercial Replacement/ Aftermarket Dynamics



- Aftermarket and service revenue represent a substantial portion of the commercial market; this contribution has increased recently due to COVID-related delays for new construction
- The commercial segment could experience more frequent equipment replacement due to greater focus on IAQ (as detailed on pages 10-11), environmental sustainability, and energy efficiency
- An expanding base of equipment, with a 20-30 year replacement cycle, translates to incremental service and aftermarket business

AIA Architecture Billing Index (ABI)



- Commercial fundamentals are improving, as the ABI, an indicator of non-residential construction spending based on the 9-12 month lead time between billings and spending, recently reached the highest level in 13+ years
- ABI readings showed weakness for most of 2020, accurately predicting this year's slower pace of spending
- The AIA's consensus construction forecast calls for non-residential spending growth of 4.6% in 2022 after expected contraction of nearly 4% in 2021, with segment forecasts shown to the right

U.S. Construction Spending Forecasts for Key End Markets

	2021	2022
Industrial	-4.1%	+4.8%
Office	-5.6%	-0.1%
Healthcare	+1.4%	+4.4%
Institutional	-2.3%	+3.6%
Retail	-1.3%	+5.8%
Hotel	-19.9%	+18.9%

- Spending in 2022 should benefit from pent-up demand in industrial markets, along with retrofitting office space for new configurations
- Renewal of deferred maintenance and replacement spending in institutional markets should support the return to growth in 2022
- Outside of the segments listed above, high growth is expected for spending on constructing data centers, which have substantial HVAC requirements

GEOGRAPHIC CONSIDERATIONS IN CLIMATE TECH MARKET

Many contributors to the positive outlook across the globe

North America

16%

2015-2019 CAGR for U.S. mini-split residential unit shipments

- Heavy usage of ducted technology across residential and commercial segments is likely to continue even amid inroads by ductless / mini-split technology
- Usage of mini-split technology is growing rapidly, particularly in certain residential applications, with advantages including ease of installation and energy efficiency
- Commercial applications are also seeing share gains for energy efficient products, including variable refrigerant flow (VRF) systems that feature a lower total cost of ownership

Europe

13%

2015-2020 CAGR for Europe residential heat pump unit sales

- Usage of mini-split technology dominates in Europe, supported by flexibility of applications as well as superior energy efficiency
- HVAC technology in Europe increasingly features energy efficient heat pumps enabling more users to comply with environmental policies and efficiency requirements
- Air conditioning is likely to experience further penetration from low levels over time, as the regulatory drive for minimized heat loss in buildings creates the need for forced cooling

Emerging Markets

65%

Projected middle-class population growth from 2020 to 2030, excluding U.S. and Europe

- Major trends toward increased urbanization and large growth in the middle-class population in developing markets bode well for climate technology demand in large parts of the world
- Emerging markets should continue to focus on energy efficient products given resource constraints and (in some cases) regulatory requirements
- Equipment and components manufacturers serving emerging markets in Asia regularly introduce innovative products that support greater uptake at premium pricing

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An Experienced, Proven, and Trusted Advisor in the Climate Technology Sector

Baird has a leading global investment banking franchise within the Climate Technology sector. Our integrated team has extensive experience in providing advisory and financing services to public companies, private business owners, and equity sponsors in transactions across Climate Technology categories as part of our broader Thermal Technology sector coverage.

BAIRD'S CLIMATE TECHNOLOGY TRANSACTION EXPERIENCE

PROTECT PLUS 
 A Portfolio Company of
hkw
 Sale to
FREUDENBERG

Manufacturer of residential air filters


 A Portfolio Company of
 ALIGN CAPITAL PARTNERS
 Sale to
PENTAIR

Manufacturer of pool, spa, and industrial air filtration products


 A Portfolio Company of
CATTERTON
 Sale to
THOR
Go Everywhere. Stay Anywhere!

Manufacturer of HVAC systems for RV, industrial, and commercial markets


 A Portfolio Company of
ACP
 Sale to
 Filtration Group¹
 A Vertical of
MADISON INDUSTRIES

Provider of air purification media for mission-critical environments


 A Portfolio Company of
 Malrose
 Sale to
MADISON INDUSTRIES

Manufacturer of air management and air quality solutions

GIL-BAR
 Sale to
ICG

Custom design and maintenance of commercial HVAC systems


 A Portfolio Company of
TJM Capital Partners
 Sale to
 WIND POINT PARTNERS

Commercial refrigeration and HVAC services provider

THE JORDAN COMPANY
 Acquisition of
HEARTLAND HOME SERVICES
 A Portfolio Company of
NORTH BRANCH CAPITAL

Residential HVAC service provider


 REGISTERS & GRILLES
 Sale to
CSW INDUSTRIALS

Manufacturer of passive air handling products


 A Portfolio Company of
3i
 Sale to
inflexion

Manufacturer of pumps and condensers for HVAC applications


 Acquisition of
MUNCH'S
 A Portfolio Company of
Rotunda

Wholesale distributor of residential HVAC products


 A Portfolio Company of
One Equity Partners
 Sale to
ae Industrial Partners

Provider of commercial and industrial HVAC systems


 Sale to
MANN + HUMMEL

Manufacturer of HVAC filtration products


 A Portfolio Company of
SUN CAPITAL PARTNERS, INC.
 Sale to
ONE ROCK CAPITAL PARTNERS

Manufacturer of electronic components for appliances and HVAC


 A Portfolio Company of
THE JORDAN COMPANY
 Sale to
PERMIRA

Manufacturer and distributor of HVAC components

watsco
\$609,938,640
Common Stock
 Bought Deal

Distributor of HVAC and refrigeration equipment


 A Portfolio Company of
Insight Equity
 Sale to
AAF
 A Subsidiary of
DAIKIN

Manufacturer of residential and commercial air filters


 A Portfolio Company of
WELLSPRING CAPITAL MANAGEMENT LLC
 Sale to
HARBOUR GROUP

Manufacturer of commercial and industrial boilers

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