



HEATING & AIR-CONDITIONING CONTRACTORS IN THE US

HEATING UP: An increased emphasis on the importance of air-filtration will likely support demand
John Madigan | December 2021

Information provided by SCA Advisors Inc. directly to Dan Altom of SCA Advisors. US
Industry (NAICS) Report 23822A, John Madigan, December 2021.

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ABOUT SCA ADVISORS

SCA Advisors, purchased in 1996 by Dan Elliott, has expanded from 1 broker to 12 business broker experts in Houston. Our brokers are a talented mix of industry professionals, business owners, real estate experts and community leaders. We have over two decades of business sales history and a great deal of experience working with all types of buyers – from strategics to private equity, and family offices to high net worth individuals.

SCA Advisors is the world's largest business broker specializing in the confidential sale of privately held businesses in Texas. We have sold over 600 businesses in the local Houston area alone, creating numerous jobs, helping business owners successfully retire, and giving new buyers the opportunity to achieve their entrepreneurial dreams.

We take pride in providing quality services to all buyers and sellers. This ensures that both the buyers and sellers will be left fully satisfied with the transaction whenever **SCA Advisors** is involved. We've worked with all types and sizes of businesses, in a variety of industries and we walk our clients through the steps of how to buy a business.

ABOUT THIS INDUSTRY

INDUSTRY DEFINITION

This industry comprises companies that primarily install and service heating, ventilation, air-conditioning (HVAC) and refrigeration equipment. Operators perform tasks that include new installations, additions, alterations, maintenance and repairs. Plumbing and related activities are not included in this report.

MAJOR PLAYERS

There are no major players in this industry.

MAIN ACTIVITIES

The primary activities of this industry are:

- Air-conditioning system installation (except window units)
- Air vent installation
- Furnace conversions (i.e. from one fuel to another)
- Refrigeration system (e.g. commercial, industrial or scientific) installation
- Heating, ventilation and air-conditioning (HVAC) contractors
- Furnace humidifier installation
- Natural gas fireplace installation
- Duct work (e.g. cooling, dust collection, exhaust, heating and ventilation) installation
- Ventilation equipment installation
- Heating and ventilation system component (e.g. air registers, diffusers and filters) installation

The major products and services in this industry are:

- New construction HVAC installations
- Existing structure HVAC installations
- HVAC maintenance and repairs
- Refrigeration system installations, maintenance and repairs

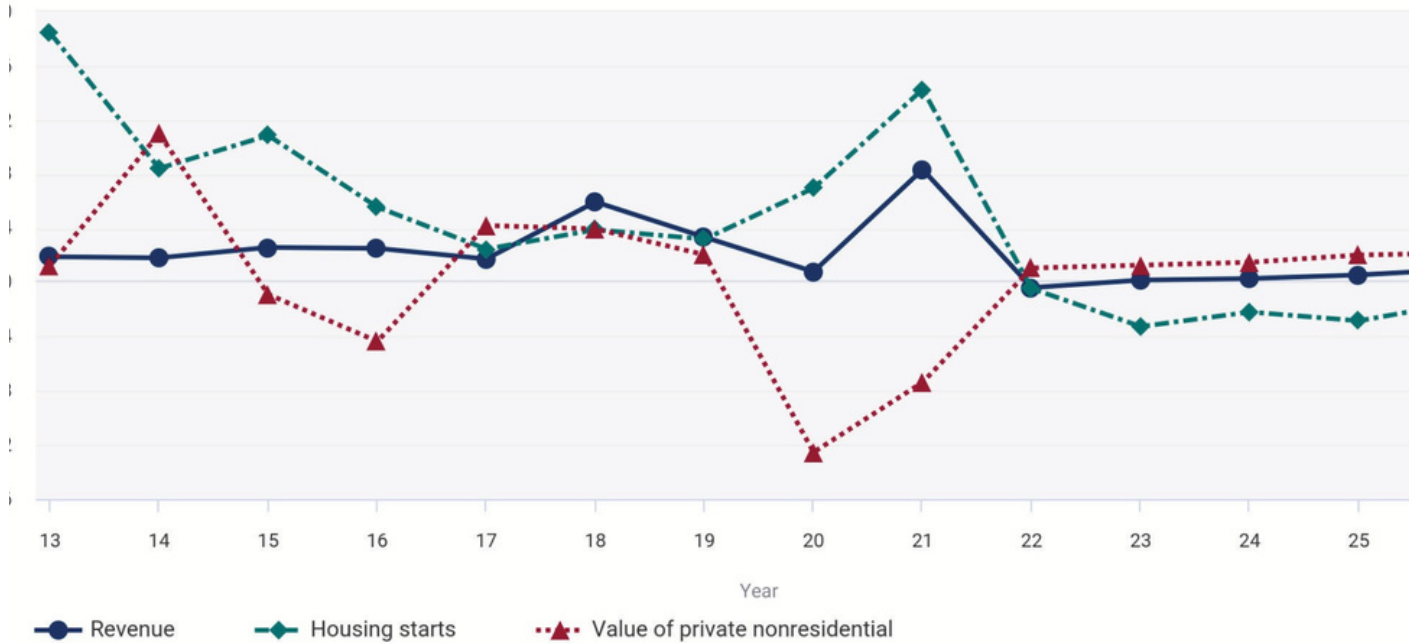
**HEATING UP:
AN INCREASED EMPHASIS ON THE
IMPORTANCE OF AIR-FILTRATION WILL
LIKELY SUPPORT DEMAND.**

Demand for the Heating and Air-Conditioning Contractors industry experienced consistent growth for the majority of the five-year period to 2021, in line with broader economic expansion. Industry operators are primarily engaged in the installation, repair and maintenance of heating, ventilation, air-conditioning (HVAC) and refrigeration systems. As a result, revenue growth is influenced by trends in broader construction activity, where market-specific dynamics also influence demand for industry services. While positive trends in construction benefited the industry for the majority of the five-year period, economic disruption from the COVID-19 (coronavirus) pandemic is expected to disrupt the industry's expansion, while also reducing general profitability. Overall, industry revenue is forecast to rise at an annualized rate of 4.0% over the five years to 2021, totaling \$120.2 billion, which includes a significant bump of 8.4% in 2021 alone as residential construction activity surges amid shifting demographic preferences.

Growth in the broader economy during the five-year period produced a favorable housing market, while also accelerating home improvement spending and new construction projects. Similarly, healthy domestic business activity enabled many companies to seek expansion through new facilities and office spaces. As a result, the value of nonresidential construction increased in line with residential construction values. Nonetheless, economic fallout from the coronavirus pandemic is expected to stagnate the majority of domestic construction activity, due to countervailing trends in residential and nonresidential construction activity in 2020.

Still, government response to the pandemic is expected to prevent further decline, while also providing incentives for strong recovery. In fact, aspects of the Coronavirus, Aid, Relief, and Economic Security (CARES) Act, have qualified many HVAC projects for increased tax relief, incentivizing many businesses to invest in new systems. Further, increased emphasis from both businesses and consumers on the importance of air-filtration is expected to provide the backdrop for significant growth over the coming five years. Thus, **SCA Advisors** expects total revenue to increase at an annualized rate of 0.3%, totaling \$122.2 billion over the five years to 2026, as key downstream markets stabilize and the broader economy emerges from pandemic recession. Still, material effects of the pandemic remain uncertain.

Key External Drivers 2013–2026



KEY EXTERNAL DRIVERS

Housing Stats

Industry contractors derive a substantial share of revenue from installing HVAC equipment and ducting in new residential buildings and structures, which include single-family homes and multifamily residences, such as apartment buildings. Consequently, growth in housing starts will likely benefit the industry. Therefore, the rebound of the residential construction market in recent years has helped industry operators. Housing starts are expected to rise in 2021, presenting the industry with a potential opportunity.

Value of private nonresidential construction

Private investment in nonresidential structures consists of new construction and renovations associated with nonresidential buildings, including commercial, industrial, educational and religious structures. This industry derives a substantial share of its revenue by installing, maintaining and repairing air-conditioning, climate-control and refrigeration systems in nonresidential buildings. As a result, the industry benefits from increases in private investment in nonresidential structures. The value of private nonresidential construction is expected to decrease in 2021, posing a potential threat to the industry.

Per capita disposable income

Per capita disposable income represents an individual's ability to purchase goods or services. This is an important driver of industry demand due to the industry's reliance on homeowners for upgrades, renovations and maintenance activity. Therefore, operators benefit from increases in per capita disposable income because consumers have more income to spend on housing renovations and additions. Per capita disposable income is expected to increase in 2021 directly resulting from government stimulus in response to the COVID-19 (coronavirus) pandemic.

30-year conventional mortgage rate

The 30-year conventional mortgage rate measures the average interest rate for the most common loan home purchasers use. As the 30-year conventional mortgage rate increases, so does the borrowing cost associated with buying a home. In 2021, the 30-year conventional mortgage rate is expected to rise.

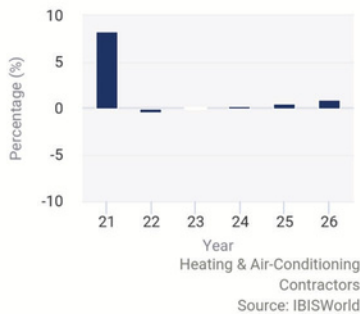
Value of residential construction

The value of residential construction consists of construction for new residential buildings. As the value of residential construction increases, demand for industry services increases in tandem. In 2021, the value of residential construction is expected to rise sharply.

OUTLOOK

Demand for the Heating and Air-Conditioning Contractors industry’s services is anticipated to increase over the five years to 2026 as the broader domestic economy rebounds following the COVID-19 (coronavirus) pandemic, though growth is anticipated to decelerate as the boom to residential construction activity fades and nonresidential construction activity trends upward again, but at a slow rate.

Industry Outlook
2021-2026



Return to growth in nonresidential markets is forecast to continue boost demand for new heating, ventilation and air-conditioning (HVAC) installations, the industry’s primary service segment. Further, government incentives related to HVAC installation and retrofittings on existing buildings are expected to create a healthy environment for pandemic recovery and continued growth from commercial and industrial clients. Similarly, expanding per capita disposable income and the growing popularity of energy-efficient systems along with heightened focus on air-quality is expected to drive demand for installations. Thus, **SCA Advisors** expects industry revenue to increase at an annualized rate of 0.3% over the five years to 2026, totaling \$122.2 billion.

PANDEMIC-RELATED INCENTIVES

As mentioned in the Current Performance chapter, HVAC systems have been qualified for bonus depreciation as a result of the Coronavirus, Aid, Relief, and Economic Security (CARES) Act.

In general, this provides a substantial financial incentive for businesses to consider new HVAC installations or upgrades on existing systems. While this dynamic represents an important driver, the catalyst for substantial recovery and further expansion is expected to result from heightened focus on air-quality in the commercial and residential construction space. Since the coronavirus pandemic is an airborne pathogen, higher levels of air exchange reduce infection risk for occupants of a building, according to the American Society of Heating, Refrigeration and Air-conditioning Engineers. As a result, systems that with more advanced filtration systems are becoming increasingly popular in high-end residential markets as well as commercial buildings, since poor air quality would deter potential customers. Similarly, healthcare and educational institutions are expected to align with this trend to reduce infection risk among patients and students, underlining the broader demand of HVAC systems in varying sectors. Overall, this dynamic, coupled with government incentives provided by the CARES Act, represents the largest contributor to industry growth potential over the coming five years.

INDUSTRY LANDSCAPE

Following pandemic declines, consumer spending is expected to improve over the coming years, benefiting both residential and nonresidential construction activity.

Housing starts are forecast to decline over the next five years, while the value of private nonresidential construction is expected to rebound significantly, increasing at an annualized rate of 2.7% during the same period.

Furthermore, per capita disposable income is projected to increase over the next five years, enabling consumers to upgrade to newer, energy-efficient HVAC units and related maintenance services. Further, as demand improves, industry profit is expected to increase from weakness attributed to high building costs.

The combination of revenue growth and profit stability is expected to attract new operators into the industry. Thus, the number of industry enterprises is forecast to rise at an annualized rate of 1.0% over the next five years, reaching 123,310 companies. As a result of increased participation, industry employment is forecast to increase at an annualized rate of 0.8% to 589,420 workers during the same period. Much of this growth is expected to be a result of independent contractors finding increasing work in the single-family housing market. Meanwhile, the industry's largest companies are expected to benefit from a trend toward customization among commercial clients, which are projected to seek out efficient and automated systems designed for particular structures.

NEW STANDARD PRACTICES

Households and businesses are expected to begin replacing outdated and less efficient HVAC systems with newer models that provide additional heating and cooling output while requiring less power.

The combination of increased disposable income and corporate profit, as well as adherence to government-mandated seasonal energy efficiency ratios (SEERs), will likely raise demand for these energy-efficient systems. Additionally, growing public concern over greenhouse gas emissions and climate change will likely make these systems more attractive to consumers seeking more environmentally friendly, contributing to this growing trend toward replacements.

NEW STANDARD PRACTICES

Increases in disposable income and corporate profit are expected to support the trend toward upgrading systems during the outlook period. Therefore, consumers and companies are anticipated to invest in systems that will likely either lower or smooth out volatility in monthly costs, such as energy payments. Heating and air-conditioning system manufacturers will likely capitalize on this development, and on widespread concerns about energy efficiency and environmental stewardship. According to 2016 data from Contracting Business (latest data available), a leading industry publication, adding variable-speed technology to new home HVAC systems can yield an increase of between four and five SEER points because it can reduce a system's environmental footprint by up to 40.0% (latest data available).

MARKET SHARE CONCENTRATION**Concentration in this industry is LOW**

The Heating and Air-Conditioning Contractors industry is characterized by a low level of market share concentration, where no single operator is expected to capture more than 5.0% of total revenue in 2021. The industry's high fragmentation results primarily from the low barriers to entry, expansive and diverse customer markets and lack of large-scale national players.

In general, the majority of industry operators are smaller companies, where the average industry enterprise is expected to employ less than 5 individual workers in 2021, remaining constant during the five-year period. Conversely, only an estimated 1.2% of operators employ more than 100 individuals, underlining the prevalence of small-scale operators. These small-scale operators, known as nonemploying companies, typically represent independent contractors, that compete in highly localized markets across the United States. Furthermore, this fragmentation can be amplified by the diverse range of potential customer groups. In terms of potential customers, heating, ventilation and air-conditioning (HVAC) contractors serve clients across the commercial, residential and industrial construction industries. As a result, operators entering the industry can capture market share by specializing in a particular customer group. For example, both Emcor Group Inc. and Comfort Systems USA Inc., the two largest industry operators, generate the majority of industry-relevant revenue through industrial and commercial clients. Since industrial and commercial HVAC systems often require more significant upfront investment, larger operators tend to serve these customer markets, while small-scale operators address localized residential markets. Over the past five years, market share concentration is forecast to have increased as larger companies acquire and consolidate smaller competitors to bolster revenue.

SCA Advisors identifies 250 Key Success Factors for a business. The most important for this industry are continued on the following page:

KEY SUCCESS FACTORS**Having a good reputation:**

Contractors need to establish a reputation for quality, timeliness, price and fiscal accountability within their local market.

Management of seasonal production:

Managing a steady workflow despite wide seasonal fluctuations is important for industry success. Operators must also be capable of reading construction cycles and adapting their workflow accordingly.

Ability to compete on tender:

Operators must have the capacity to contest and hold ongoing maintenance contracts to generate a stable revenue base. Larger operators must also be able to compete for contracts in lucrative commercial building markets.

Ability to quickly adopt new technology:

Operators must adapt quickly and keep up to speed with changing technology, particularly regarding energy efficient and smart climate control systems.

Ability to vary services to suit different needs:

The capacity to supply total facilities management enhances the prospects of success in this industry.

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