EXECUTIVE INSIGHTS

Geospatial Intelligence: The Key to Growth for Residential Services

Over the past several years, residential services businesses have performed well. This success has prompted owners to consider expansion opportunities and has made the sector an investment focus for both strategic and financial buyers. Many of the services these companies provide are viewed as nondiscretionary, which makes them especially attractive during times of economic uncertainty.

The growing interest in these companies has led to more competition for assets and sometimes a mismatch between seller and buyer estimates of what a company is worth. Furthermore, the past decade has seen the emergence of aggregator platforms that consolidate mom-and-pop services businesses, ramping up competition for assets.

Bottom line: Investors need to be sharper about the companies they are buying, while sellers must justify why they are particularly well positioned.

Identifying your expansion model

We have found that there are five primary considerations that acquirers must address for their own business and when identifying potential targets:

1. **Customer acquisition model.** Does the business have a differentiated and defensible approach to acquiring customers that keeps its acquisition costs lower than those of its competitors?
2. **Delivery model.** How well is the business actually delivering? How do consumers perceive its service in comparison to that of other aggregators, scaled local players, and mom-and-pops? To what extent does that vary by geography?

3. **Pricing model.** Has the business isolated pricing levers, and can it determine where to set its pricing by service in order to maximize revenue?
4. **Operating model.** Does the business have a clear plan (organizational, operating and post-M&A aggregation) for how it will add value to the aggregated service company without losing synergies in serving customers or engaging employees?
5. **Geographic model.** How well-positioned is a target to serve its current geographic markets? What white space remains? Where could it expand next?

Many successful residential and commercial services businesses are fundamentally geography-based businesses serving local catchments; therefore, this edition of L.E.K. Consulting's *Executive Insights* focuses on the geographic model.

Getting smarter about geographic growth

Residential and commercial services businesses are local by definition. Each company, or each branch of a larger company, services a specific geographic area. Whether it's an HVAC enterprise, a landscaper, a plumbing business or a roofing company, a service professional needs to drive to the customer's location to deliver the service. The longer the drive, the fewer the customers that can be serviced in a day. Therefore, every business needs to define the specific catchment area it is willing to service.

A host of other factors will affect the attractiveness of a particular area or target company. Housing density, traffic patterns, demographics, weather intensity and competitive density all come into play. In fact, we have looked at more than 60 variables by local market to understand what local factors drive success for a local business.

Whether you are a company considering expansion options or an aggregator looking at specific target companies, geography should be a central component of your decision-making process, and it is critical to ask the right questions (see sidebar).

Asking the right questions about location

- Existing markets: Assessing positioning in existing markets
  - How well-located are our branches to capture metropolitan statistical area (MSA) spend?
  - How do we show that our branches are well-positioned in a sell-side process?

    - How can we be sure we are buying an asset that is well-placed geographically?

- Existing markets: Finding new sources of growth within existing markets
    - Where are there pockets of underserved demand (where spending on services is relatively high and competitive density is relatively low)?
    - Where might we add a satellite branch to capture new spend?

- New markets: Selecting and determining where to locate
    - What defines an attractive geographic market/MSA?
    - Which MSAs are most attractive?
    - Within the attractive MSAs, what are the most attractive ZIP codes (to target acquisitions)?
    - How well-positioned are the targets we are considering in terms of their ability to capture MSA spend?
    - How do we assess a target's growth plan? (Is it targeting the right MSAs?)

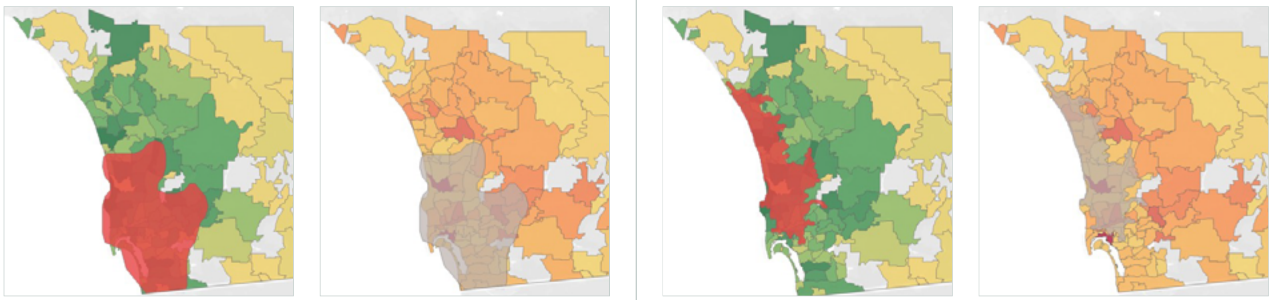
Using geospatial analysis to inform decision making

The number of elements that can affect the success of a purchase or expansion decision can be overwhelming; fortunately, tools exist to help buyers, aggregators and owners chart effective, data-informed growth plans. The following are just a few ways we can apply geospatial analysis.

Assessing positioning in existing markets

Consider a buyer that is weighing the attractiveness of two potential targets. We begin by mapping drive times to create a catchment area — in the example here, the catchment is defined as the area within a 20-minute drive of each target. We then analyze spend at the ZIP code level to assess a branch's ability to capture share in its MSA. Finally, we overlay competitive density onto these maps at the ZIP code level to assess where competition is higher versus lower (see Figure 1).

Figure 1
Target catchment coverage comparisons



	Target A: ZIP code-level spend	Target A: ZIP code-level competitive intensity	Target B: ZIP code-level spend	Target B: ZIP code-level competitive intensity

	Target A	Target B
Percentage of MSA spend captured in 20-minute catchment	~67%	~39%
Accessible market demand	~$590M	~$340M
Accessible EBITDA*	~$120M	~$70M

All else being equal, Target A has significantly more runway for growth given its location in the MSA.

Lower spend — Higher spend
Company catchment regions

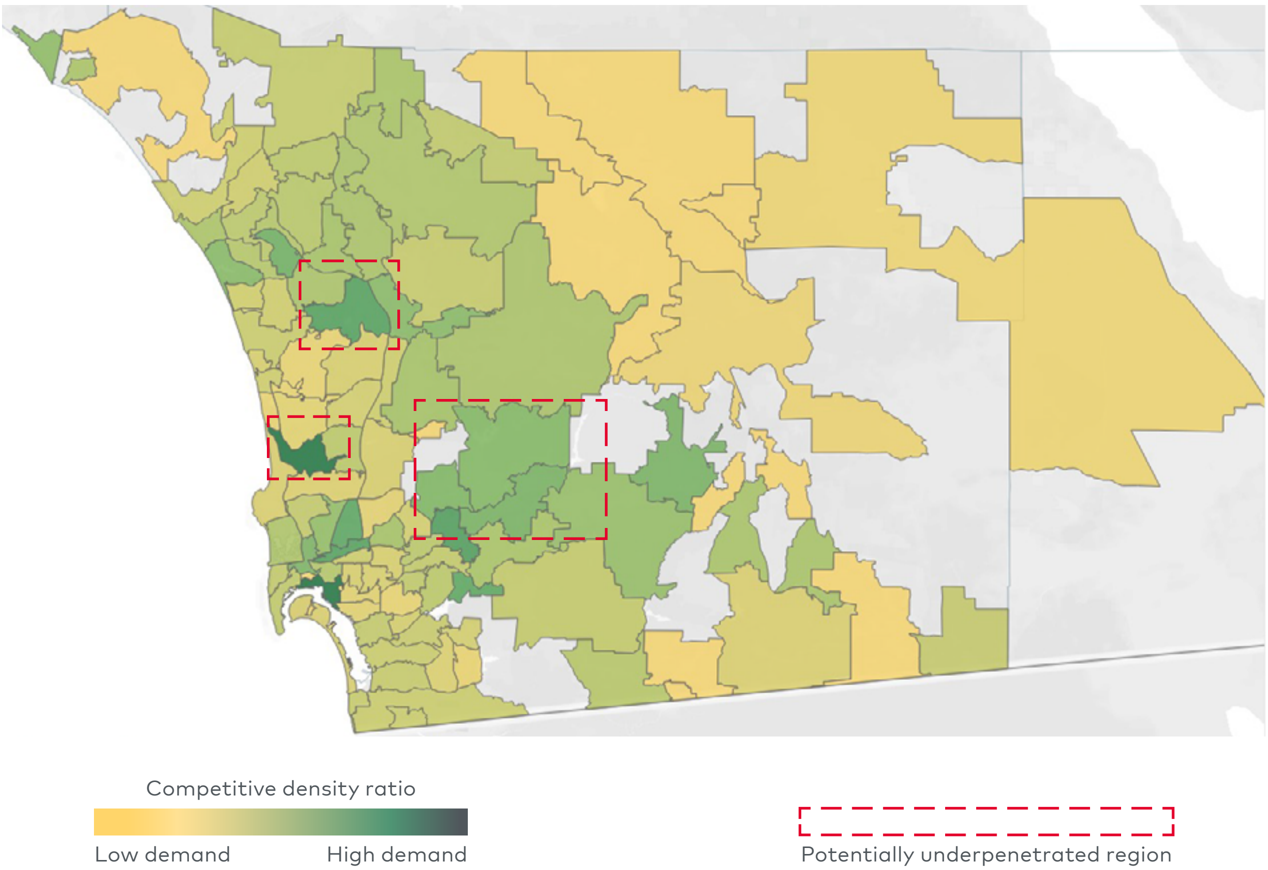
*Assumes 20% EBITDA margin
Note: MSA=metropolitan statistical area; EBITDA=earnings before interest, taxes, depreciation and amortization
Source: L.E.K. research and analysis

In this example, Target A's location is better placed to capture spend, given that it can serve 67% of the accessible market versus Target B's 39%. That translates into a difference of $50 million in accessible earnings before interest, taxes, depreciation and amortization (EBITDA) between A and B.

Finding new sources of growth within existing markets

Geospatial analysis can also identify underserved areas for new branches or determine where to target acquisitions by pinpointing areas with relatively higher spend and lower competitive density. In the example shown in Figure 2, we create a ratio of spend to competitive density. Those areas with the highest spend and lowest competitive density are the best ones to target for acquisitions or opening new branches.

Figure 2
Market demand and competitive density map

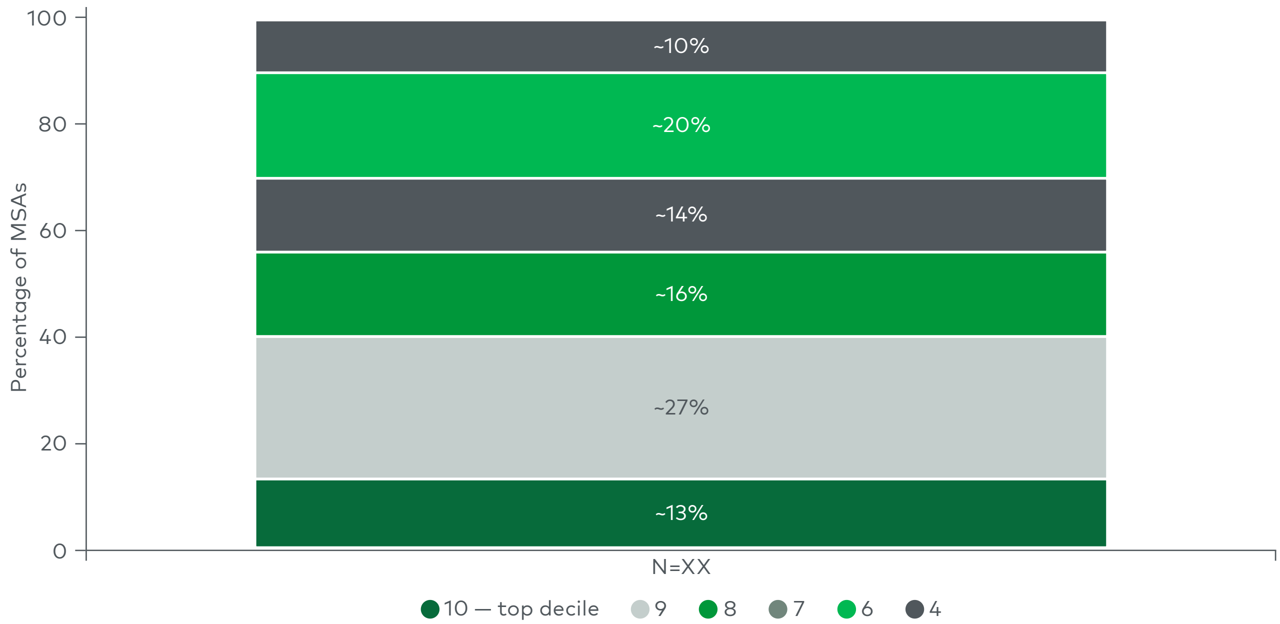


Source: L.E.K. research and analysis

Finding new markets

Every business has a unique profile, which is why a company must identify those elements that are most critical to its business, including economic factors, construction activity, weather, demographics, etc. We can use these elements to derive an "index of success." This index can be used to assess not only a company's current portfolio but also its growth plans — specifically, the MSAs it is targeting for expansion. Figure 3 shows an example of this application. MSAs are grouped into deciles against which a company's assets have been assessed. In this example, 40% of the target's assets are in the top two deciles.

Figure 3
Illustrative decile ranking of a service company's MSAs* (2021)



*Decile ranking takes into account factors such as population, population growth, population density, housing stock and growth, household value and household income
Note: MSA=metropolitan statistical area
Source: Company websites; U.S. Census; Woods & Poole; L.E.K. research and analysis

Location: A treasure trove of information

Residential and commercial services are likely to remain attractive businesses for the foreseeable future. But voracious aggregation or expansion may not yield the best results, particularly as competition for these companies increases. Clearly, some businesses are more attractive than others, and location is a key contributor; however, location is complex, and myriad factors determine which locations are the best fit for which companies. Companies that complement their traditional decision-making toolkits with geospatial analysis will be rewarded with expansion plans that yield optimal results.

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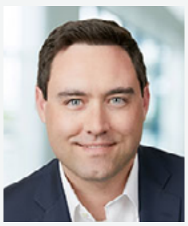
Paul Bromfield is a Managing Director and Partner based in L.E.K. Consulting's New York office. Paul is a member of the firm's Industrials practice, with a specialized focus on the building and construction industry. He has more than 20 years of experience and a strong record of helping companies across the value chain accelerate growth, including service innovation, digital acceleration, and diversification through M&A and new ventures. He brings expertise in commercial sectors, exterior products, organizational implementation and how companies can adapt to sustainability.



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