

Customer & Market Due Diligence Of Leading Janitorial Services Provider: Establishing COVID Impact And Local Market Competitive Dynamics

The Challenge: One of our longtime PE clients was considering an investment in a janitorial services provider with national presence. The target had grown rapidly through a series of acquisitions and had superior profit margins relative to the market average. Attracted by the target's strong margins and geographic expansion opportunity, our client wanted to better understand its competitive positioning in its local markets, the drivers of its high margins, and how it is performing with its top customers. Accordingly, the client asked Gotham to conduct a 3-week customer & market due diligence to establish: (1) the janitorial services market size and growth outlook; (2) target's competitive positioning in its local markets; and (3) the impact of COVID and wage increases on target's business.

Fact-based Local Market Assessment: Given the fragmented and local nature of this market, Gotham conducted a bottom-up, multi-pronged effort that entailed:

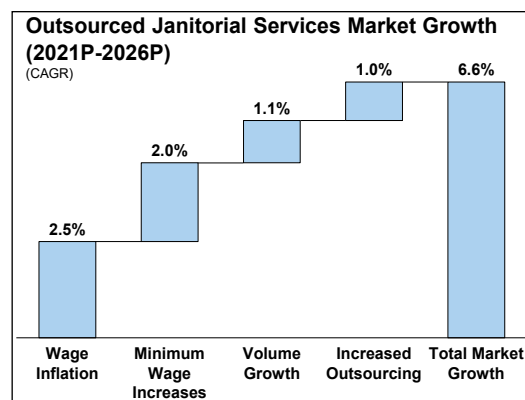
- Carrying out ~40 interviews and ~175 online surveys of janitorial services buyers (customer and non-customer) to gain insights into: impact of COVID on janitorial services/spend and impact of hybrid/remote work on janitorial services needs; RFP process and vendor selection criteria; competitive landscape and target's reputation/positioning; and impact of labor supply constraints/wage inflation on janitorial services pricing, as well as any built-in price increase mechanisms in their contracts
- Deciphering competitive dynamics of this highly fragmented market by segmenting 60K+ janitorial service providers by size and leveraging primary/secondary research to determine competitive segments
- Creating a competitive database for each of target's local markets, identifying all players in each market (national, regional, franchise, large local, and mom & pop players) and profiling all key players
- Building a market model leveraging government and industry data to establish historical and projected market growth and contribution of key growth drivers.

COVID Shutdown Demand Impact Partially Offset By Enhanced Sanitation Protocol; No Long-Term Impact Expected

The impact of the COVID shutdown varied by end-market, with some (e.g., offices, retail stores) seeing a reduction in janitorial service needs during initial lockdowns, while others (e.g., warehouses, grocery stores, hospitals) required more janitorial services. The initial impact of lockdown was partially offset by frequent, high-touch surface cleaning, misting, and other enhanced sanitation protocols that not only increased safety, but also visually assured customers/occupants. Over time, the gradual return to in-person activities has led to janitorial services requirements being almost back to pre-COVID levels, with some enhanced sanitation protocols to continue. While corporations plan to continue some remote work arrangement moving forward, only a small minority indicated a reduction in physical office footprint and even then increased sanitation requirements for hot desks would result in almost no impact on janitorial services.

6.6% CAGR Janitorial Services Market Growth Driven By Price Increases, Building Space Growth, And Increased Outsourcing

Gotham's market size model indicated the janitorial services market is expected to grow at 6.6% CAGR, with the bulk (4.5%) driven by wage inflation as minimum wage increases and labor supply constraints increase labor cost. Gotham established that price increase mechanisms range from contracts with built-in price increases to customers being open to mid-contract increases (especially to good vendors) to waiting until the end of the contract to increase prices. Growth in building space is expected to contribute an additional 1.1% CAGR growth in demand for janitorial services with general economic growth driving new building construction. Roughly 1% of market growth is attributable to increased outsourcing of janitorial services, driven by retirements, challenges in recruiting and retaining janitorial staff, and liability considerations.



Target The Leading Player In A Highly Fragmented Market With A Focus On Higher Margin Segments

The janitorial services market is highly fragmented with 60K+ players overall, the vast majority of whom are Mom & Pop players. Only a narrow subset of the market comprises "sophisticated" players, including the target, that are able to serve national chains and large local properties. Serving national chains requires national ISP networks, ability to bid/manage large contracts, technology to manage thousands of requests, and organization structure/communication mechanisms for day-to-day management – the target is among the only handful of players that can serve these national chains. In local markets, large properties/campuses, with their hundreds of thousands to millions of sq. ft. of space, have complex requirements and multi-million-dollar contracts, requiring vendor sophistication to handle bidding and daily management – the typical competitive set for these large accounts includes 1-2 national players, 1-2 regional players, and a couple of strong local players. Target is typically a leader in its local markets, with a good reputation for quality of service, local account leadership, customer relationships, and management support. Target's higher margins are driven by its focus on geographies and end-markets with limited competition, providing pricing power. As such, target is underweight in more commoditized end-markets (e.g., office) while having strong presence in more complex end-markets that require specialized knowledge/capabilities (e.g., hospitals, malls, schools).

The Outcome: Gotham provided the client with clarity on: the janitorial services market's competitive structure and growth outlook, target's competitive positioning in its local markets, and impact of COVID and labor cost increases on janitorial services, allowing the client to successfully close the deal with confidence. Soon after closing the platform acquisition, the client did a sizeable add-on serving a different geography and requested that Gotham conduct a customer due diligence of the acquisition's top 20 customers.