



*RKJ Partners, LLC is an Atlanta, Georgia based investment banking firm designed to specifically assist lower middle-market growth companies in executing transactions between \$2MM to \$75MM.*

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# ***Pest Control Industry – M&A Update***

**MAY 2011**

## **I. OVERVIEW**

Near the end of 1Q11, RKJ Partners, LLC (“RKJ”) noted continued momentum for M&A activity in the pest control services industry, tracking decently to activity in 2010 – a year that saw a massive push to pursue and complete deals and that was highlighted by more transactions of \$5M plus companies than in the last seven years. All indicators we are monitoring, combined with proprietary feedback received from the market, strengthen our belief in the following:

- ❖ Due to the slow pace of economic recovery, for many pest control owners that sat on the sidelines in 2008/2009/2010, “waiting” no longer makes sense. Key decision makers and their trusted advisors are reevaluating price and valuation expectations in the context of still relatively strong M&A activity for their industry.
- ❖ Large national and regional industry players armed with “cash-rich” balance sheets remain focused on expansion and growth strategies as opposed to preservation.
- ❖ The extension of the Bush tax cuts will motivate, accelerate and heighten activity as sellers seek to actively manage after-tax proceeds by executing transactions while capital gains taxes are still relatively low.
- ❖ Private equity firms continue to set their sights on the industry, and have been among the bidders for acquisitions in the recent year.

## **II. 2010 M&A IN REVIEW**

For the first time in over 10 years, the pest control industry witnessed what can be best described as a buyer’s market with 2010 proving to be an active year for merger and acquisition activity. The significant upswing in completed transactions was fueled not only by the consolidation efforts of the largest industry players (Terminix, Orkin, Rentokil) but by smaller, regional players (Arrow Exterminators, Alpha Ecological) as well.

## 2010 Announced & Closed Pest Control Transactions

Date	Target	Acquiror
12/01/10	Nader's Pest Raiders	Arrow Exterminators
10/26/10	Sorrentino's Pest Control	Orkin
08/25/10	Buck's Pest Control	Orkin
08/16/10	Top Notch Pest Control of Tampa	Arrow Exterminators
08/16/10	CRW Termite & Pest Control	Victory Pest Solutions
08/12/10	Antimite Termite and Pest Control	Terminix
07/13/10	Waltham Services	Rollins, Inc./Orkin
05/04/10	All Seasons Pest Management Services	Viking Termite and Pest Control
04/28/10	Brothers Pest Control	Tempco Pest Control
04/14/10	Armand Pest Control	Arrow Exterminators
04/06/10	Cascade Pest Control	Alpha Ecological
04/06/10	Pest Control of Phoenix AZ	Alpha Ecological
04/06/10	Bug Busters	Alpha Ecological
03/29/10	Mountain Pest Control	RentokilEhrlich Pest Control
02/22/10	Executive Pest Control	Cascade Pest Control
01/12/10	JBK Pest Control	Craig Thomas Control

In assessing deal activity for the pest control industry, RKJ has identified some key themes as catalysts for this buying trend, which include:

### Motivated Owners

Many owners of pest control companies feared Congress would not renew Bush-era tax cuts expiring at the end of 2010. Potential modifications to capital gains tax rates were estimated to translate to at least a 33% increase in addition to significantly higher personal income tax rates. Business owners considering a sale in 2010 or 2011 were forced to seriously consider accelerating sale plans to ensure that the transaction took place prior to the end of 2010. To put this potential tax increase into perspective, the seller of a \$3M pest control company would owe approximately an additional quarter of a million dollars in gains taxes on a sale in 2011, versus what he/she would pay in 2010. Many sellers on the fence were pushed over the edge by this tax consideration.

### Timing of Economic Recovery

Timing the market isn't easy and was a major driver for buying activity in 2010. In 2008 and 2009, many pest control operators, either independently or at the recommendation of their advisor, sat cautiously on the sidelines due to economic uncertainty. With a slow turnaround from the recession, some of these owners decided that they couldn't wait any longer and changed their price expectations in order to execute a transaction while their business still had value. In summary, inaction in 2008/2009 gave way to action in 2010.

### Cash-Rich Balance Sheets

Armed with very healthy balance sheets and the cash to make deals happen, the pest control industry saw large national and regional players continue to focus on their strategies of expansion and growth as opposed to preservation. For the publicly-traded group, as evident from their earnings calls, there seems to be no slowing up in the deployment of cash to fund acquisitions that allow them to quickly extend their companies' geographic footprint and service offerings. As points of reference, Terminix (ServiceMaster) acquires about 25 to 50 companies a year; Orkin (Rollins) acquired 23 companies last year.

## III. 2011 M&A OUTLOOK

As the baby boomers continue to exit their businesses at a rapid pace, opportunistic, cash-rich acquirers will be in a position to seize opportunity. Quality sellers in the pest control industry should continue to see favorable valuations over the near-term and not-so-quality sellers will see less exit opportunities as the months progress.

As we track activity in recent months and look ahead to second half of 2011, RKJ's prediction is that M&A activity for the pest control industry will continue at a healthy pace. Although the large pest control companies will become more selective and no longer compete for smaller acquisitions, this will open up opportunities for private acquirers at the

lower end of the market. We believe the following fundamentals will support continued deal flow for the remainder of the year:

- ❖ Highly fragmented industry with thousands of companies moving toward consolidation
- ❖ Well-capitalized (cash-rich) national and regional players with a strong desire to diversify their customer base while establishing themselves as the “acquirer of choice”
- ❖ Cheap money (i.e. low interest rates) is decreasing the cost of capital, which is supporting an increased level of M&A activity and business valuations in general
- ❖ Extension of the Bush tax cuts accelerating activity
- ❖ Anticipated rise in bed bug customer base due to increasing public infestations

Below are announced and closed transactions year-to-date for 2011:

<b>2011 YTD Announced &amp; Closed Pest Control Transactions</b>		
<b>Date</b>	<b>Target</b>	<b>Acquiror</b>
05/04/11	Integral Pest Management	HomeTeam Pest Defense
05/10/11	Cascade Pest Control	Two Savages
03/08/11	Envincio	SantoLubes
02/08/11	CRC Services Termite & Pest Control	Skyline Pest Solutions & Home Inspections
01/05/11	Collin Services	HomeTeam Pest Defense

#### **IV. CONCLUSION**

Pest control operators that are still around will get through the remaining economic struggles if their owners can find ways to cut excess spending, reduce credit outstanding and put aside rainy day cash. Some pest control operators will be forced to take things even a step further by diversifying their service portfolios and taking advantage of weak spots that they find in their competitors’ positions. It will be inevitable that some of the smaller, local players will fold, however not because they can no longer survive the trends, but because the emotional stress of it all will just make them want out.

In the pest control industry, M&A activity is largely driven by life events. The great majority of pest control operators do not “time the market” to get the best possible acquisition multiple for the sale of their businesses. Pest control operators sell their businesses for personal reasons, such as death, divorce, burnout, illness, retirement, etc. Sale decisions for life events can be deferred in troubled times, but they cannot be avoided altogether, and we believe that pest control operators will seize the opportunity in 2011 to sell when the M&A market is still relatively strong and capital gains taxes are still relatively low.

## ABOUT RKJ PARTNERS, LLC

RKJ is an established advisor to leading lower middle-market growth companies. We provide our clients with experienced-based solutions and unbiased advice. Our comprehensive array of strategic advisory and execution capabilities allows us to meet the needs of our clients and provide an outstanding level of service in connection with a variety of transaction processes, including:

- ❖ **CAPITAL ADVISORY:** RKJ possesses substantial expertise in assisting lower middle-market clients raise capital to fund growth strategies. Whether the capital source is senior debt, mezzanine/subordinated debt, private equity, or venture capital, RKJ has both extensive and relevant relationships within the capital community to enable the deployment of optimal solutions for our clients.
- ❖ **MERGERS & ACQUISITIONS:** RKJ serves as a trusted advisor in executing merger and acquisition transactions for lower middle-market clients. In addition to our significant investment banking transactional experience, RKJ's bankers have owned businesses and have served in interim CFO roles for clients. As a result of our experiences as business owners and senior level managers, RKJ's bankers are able to bring a unique perspective to the mergers and acquisitions process. RKJ's mergers and acquisitions services include:
  - ❖ Buy-side and Sell-side Advisory
  - ❖ Divestitures
  - ❖ Leveraged & Management Buyouts
- ❖ **STRATEGIC ADVISORY:** RKJ provides financial advisory services to owners, management, shareholders and their boards to assist in the evaluation strategic alternatives and options for extending and/or maximizing shareholder value. RKJ's advisory services include:
  - ❖ Business Valuations
  - ❖ Capital Structuring & Planning
  - ❖ Negotiating Joint Ventures
  - ❖ Strategic Business Development