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The Evolving Role of Private Equity in the Paving Contractor Sector

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INTRODUCTION

Essential services businesses have been and remain companies in high demand with buyers. For the past two decades, the paving sector saw private equity-fueled consolidation, which regained steam following the pandemic. Paving is a tried-and-true category that investors still love for its consistent and predictable revenue patterns, market fragmentation, and strong margin profile.

But first, a few basics.

Private Equity Funds: Defined

Private equity funds are investment vehicles focused on acquiring privately held companies. As of mid-2021 there were over 18,000 active private equity funds in the United States, according to SEC data. Further, by analyzing data from Pitchbook and other sources, these funds invest in excess of $100B per quarter into U.S. businesses. Recently, there has been tremendous growth among the lower middle market firms that are willing to acquire smaller companies.

Private equity investments typically take shape as either a buyout or an infusion of growth capital, with the distinction being the intended use of the funds and the percentage of a company acquired. Most transactions are structured as buyouts.

In these deals, the buyer acquires control of a company — at least 51 percent but oftentimes 75 percent or more — and the sellers or key managers retain a minority ownership position going forward. These deals in turn can be classified as either a platform investment or an add-on acquisition, largely based on the size and strategy of the investment.

Types of Private Equity Deal Structures

A platform investment is the firm's initial investment in a specific industry. Platform investments must meet stringent requirements and be of a certain size; most lower middle market funds look for companies with at least $3M in EBITDA (earnings before interest, tax, depreciation, and amortization), stable cash flows, recurring revenue, and a promising outlook for the industry.

Add-on investments are acquisitions by these platform companies. There tend to be fewer requirements for add-on acquisitions, as size can be less relevant as long as the add-on is synergistic with the portfolio company.

Growth capital investments, on the other hand, also result in the creation of a new platform but can be structured as either control or non-control (minority) investments. Further, whereas in a buyout the majority of the cash component is distributed to the sellers, many growth capital investments are structured to fund growth and not pay out the sellers as in a traditional sale.

Types of Private Equity Buyers

The market for paving company acquisitions largely involves three categories of buyers:

01 **Pure strategic buyers:** groups lacking a private equity sponsor, like Heartland Paving Partners

02 **Private equity platforms:** groups aggressively pursuing add-on acquisitions like Lets Pave, which is backed by Saw Mill Capital; Rose Paving which is backed by Tenex Capital Management; and Pavement Partners backed by Shoreline Equity Partners

03 **New private equity entrants:** groups seeking to capitalize and build their own platform

Typical Timeline for a Private Equity Acquisition

PE firms manage money for outside investors, known as limited partners ("LP"), for whom they ultimately need to generate a return on their investment. In order to pay LPs a return, firms need to liquidate their investments.

Typically, a firm will hold an investment for 5-7 years, growing it rapidly during this time. Eventually, they will sell the company to another PE firm or a strategic buyer.

The Attributes Attracting PE to the Paving Industry

The paving industry attracts PE investment because it aligns very closely with criteria common to PE firms high-performing investment criteria. One key reason: paving is a stable industry with predictable demand.

The global paving market size was $3.10 billion in 2023, grew to $3.26 billion in 2024, and is expected to reach around $4.84 billion by 2032, expanding at a CAGR of 5.1% from 2024 to 2032.

Finally, the industry is highly fragmented, characterized by a few large operators and thousands of small and medium-sized companies. In 2024 the U.S. had 123,096 paving contractor businesses, which is a 2% increase from 2023. However, the interest level and activity has been steady for the last six years. Ultimately, this makes the industry ripe to streamline operations and maximize margins through consolidation.

The Attributes Attracting PE to a Particular Company

On a high level, below is a list of key attributes a paving business must have to attract the attention of a private equity buyer:

- Experienced, capable leadership team
- Low customer concentration
- Highly recurring or reoccurring revenue
- Strong customer retention
- Above-market growth
- Strong EBITDA margins

Investment Criteria

PE investors each have their own set of investment requirements. Yet typically, a company needs to generate at least $25M in revenue and $3M in EBITDA in order to be considered for a platform acquisition. However, a company may only need $5M in revenue to qualify as an add-on investment.

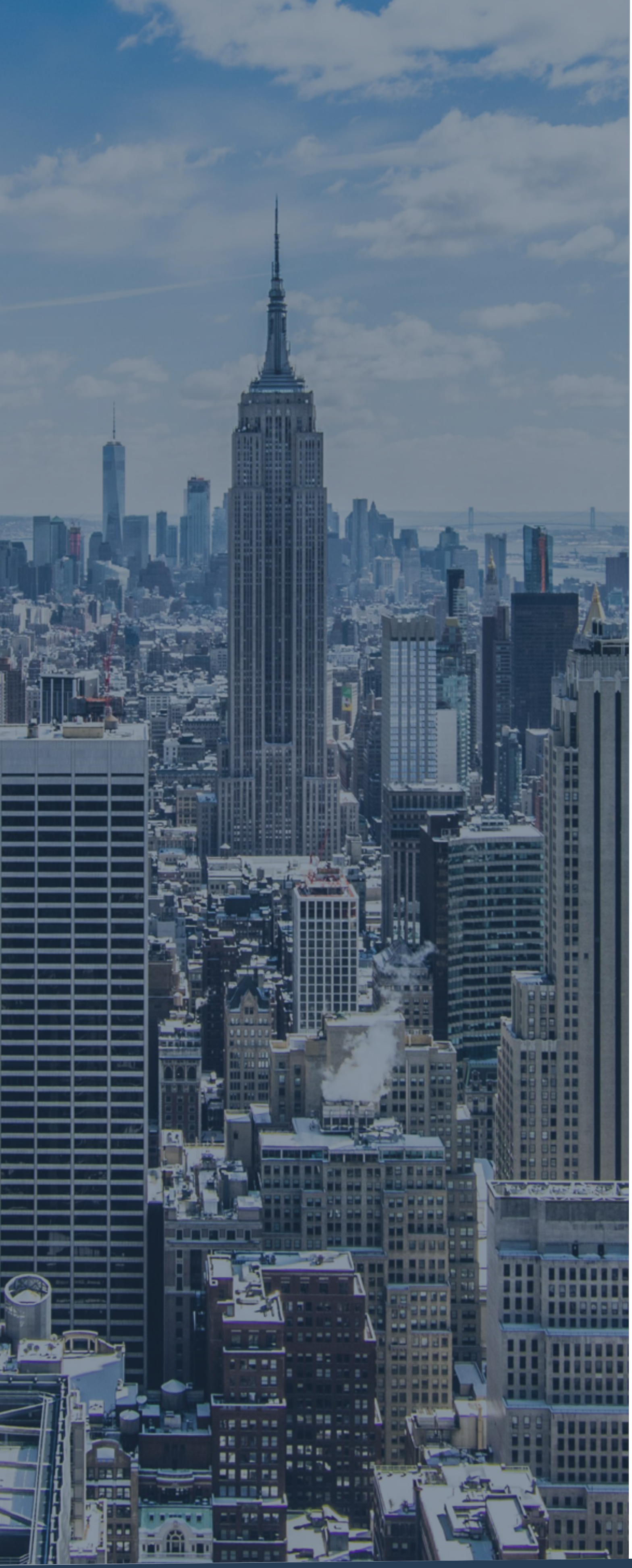
Investors are looking to acquire paving contractors with strong customer retention, low customer concentration and the ability to establish high gross margin within self-performing service lines such as asphalt repair, crack seal, seal coating and lot marking.

Established paving companies should command an EBITDA percentage at or above 15% and gross profit margins at or above 40% percent.

Geography

Historically within the United States the northern states are the most vulnerable due to freeze and thaw cycles in winter months. As a result, more repairs are needed to the asphalt, but cash flow is tight as work cannot be completed. Paving contractors in the southern states work year-round and do not have the freeze and thaw cycles.

Private Equity firms are not shy to acquire paving contractors in the northern states, however, having multiple offices throughout the country does help with cash flow in winter.



IMPACT ON COMPANY OWNERS

How Consolidation Drives Demand

Consolidation can create a more competitive market, and independent companies can expect increased competition when one or more large operators enter their space. It also creates tremendous opportunity. The entrance of new players who have specific mandates to grow through acquisitions means that the demand to acquire may exceed the supply of companies for sale.

In other words, it becomes a seller’s market.

When industries go through consolidation cycles, valuations increase as buyers compete to purchase premier companies. Such cycles can last anywhere from 5-15 years, with owners who exit amidst the frenzy, realizing massive premiums compared to the average valuations obtained during other cycles. Furthermore, the increase in the number of buyers in the market increases the options for a seller.

Platform vs Add-On

There are major differences between selling as a platform and as an add-on, well beyond any perceived financial distinctions. Even companies that fit the financial profile of a platform may find themselves transacting as an add-on.

The Case for Platforms

A platform investment nearly always requires the company to come with a CEO who retains a significant equity stake in the business going forward. In the lower middle market, that often means the owner is that CEO. How significant the equity stake must be will vary by the individual PE firm and the capital structure of the business prior to a transaction, but 20% or more is common. Not all sellers want to make this large of a commitment of either time or money.

The upside, however, can be appealing. As with most investments, those who get in on the ground floor of something successful tend to reap the biggest rewards, and the same is true for those owners who create a new platform. Their rollover equity tends to appreciate more than that of any ensuing add-on.

The Case for Add-Ons

Add-ons, however, create an easier path for the seller, as they likely involve a lower threshold for rollover and the potential for a shorter post-close commitment to the business. They may still be required to stay on for a few years if they are instrumental to either sales or operations, but that is usually a less intensive commitment compared to a platform.

Further, their day-to-day commitment is likely easier. Selling to private equity tends to be glamorized and not enough is written about just how challenging it can be to operate a business owned by private equity and report to a PE-controlled board of directors. Great challenges can yield great rewards, but they can also result in great failures.

THE INFORMATION ASYMMETRY

First-time sellers face a significant disadvantage when selling to private equity or corporate buyers. There are a variety of reasons why, but it boils down to an information asymmetry between the seller and the sophisticated buyers on the other side of the table.

The main factors contributing to this information asymmetry are the opacity of the private capital markets and the relative lack of available information about private company transactions.

In such transactions, the more experienced buyer has access to proprietary off-market information about valuations, transaction structures, and deal terms that is only available to someone with vast transactional experience and an extensive network. They can leverage this information asymmetry to purchase companies for less money and on more favorable terms than if the playing field were leveled.

As a result, several sellers unknowingly accept a less-than-optimal offer.

The Value of an Advisor

An M&A adviser can generally help a seller identify and contact potential buyers, value the seller's business, negotiate with a potential buyer, and close a deal at a lower cost than the seller would incur on its own.

Several resources exist to support company owners in a sale, with the primary being M&A advisors. A sell-side M&A advisor acts as an exclusive advisor to the company owner, representing their interests in the transaction and managing the process from pre-sale planning through to closing. A qualified advisor has a broad base of transactional experience, in-depth knowledge of an industry, and an expansive network of contacts among relevant strategic buyers and outside investors. While some firms specialize exclusively in the paving industry, company owners would be wise to retain a firm with broader expertise as they can draw from a larger network of potential buyers and contribute unique points of view to the process.

A sell-side M&A advisor will ensure that the company owner maximizes the sale process by eliminating the information asymmetry. Several studies have demonstrated that businesses sold through advisors receive higher prices than those sold by their owners, and the best firms align their incentives with their client's objectives to ensure all parties are focused on one goal.

One study analyzed nearly 5,000 transactions over 20 years and estimated that sellers who enlisted the guidance of an M&A advisor garnered valuation premiums of around 25%.

M&A PAVING OUTLOOK FOR 2025 AND 2026

Now is an excellent time to sell a paving company. There have never been so many platforms competing for add-ons, and every decent company that Caber Hill Advisors has taken to market has received multiple, competitive bids, allowing the seller to maximize value and choose a partner for reasons beyond mere economics. At the same time, there remains a seemingly unquenchable thirst for attractive new platforms.

Prospects over the next 12-18 months are bright, but trying to predict the market beyond 2025 is difficult. Even an insular industry like paving is not immune to macroeconomic factors like changes in trade policy, regulations, or interest and tax rates.

We still like the prospects for sellers over the next three to five years, as we expect demand to remain strong. However, predicting valuations beyond the near term is almost impossible.

Eventually, the ratio of supply to demand will flip. In the United States, an estimated 40% of privately held companies are owned by Baby Boomers. These owners will retire someday, and most are counting on the sale of their company as both their exit strategy and a critical element of their retirement savings. It doesn't take a rocket scientist to calculate an imminent increase in companies for sale over the next 5–15 years.

We anticipate ultimately seeing company owners competing with each other in an effort to sell, with buyers having multiple options in most markets as the supply of companies for sale exceeds demand. There will still be buyers, but the shift in the supply-to-demand ratio will put downward pressure on valuations.

This dynamic is great if you're planning to buy a company because your options will increase with each year. A company owner preparing for an exit, however, would be wise to evaluate supply and demand when determining when to sell, because those owners who sell at the beginning of this impending wave will achieve better results.

Quite regularly, Caber Hill Advisors fields queries from new paving buyers eager to make add-on acquisitions or platform investments in the space. These frequent, ever-persistent queries just reinforce our main claim: **it is a seller's market.**

ABOUT CABER HILL ADVISORS

Caber Hill Advisors assists private company owners and prospective company buyers in the sale, purchase, or evaluation of a company, and has acted as the trusted advisor to hundreds of company owners across numerous healthcare sectors. Our team has in-depth knowledge of the paving industry and close connections with its leading investors. The firm utilizes a proven process for selling companies, bringing capabilities that are often only found at Wall Street investment banks to small- and medium-sized businesses.

Peter J. Holton
Managing Director

PETER J. HOLTON, Managing Director of Caber Hill Advisors, has over 20 years of experience in sales, operations and M&A within the facility service and manufacturing industries. Prior to joining Caber Hill, Mr. Holton worked with Craig Castelli at Bridge Ventures in Chicago. He began his career working in the construction industry, spending nearly a decade at Rose Paving Company where he held both regional and national positions in a variety of roles, including business development, operations, sales and mergers and acquisitions.

Here is what the President of Horizon Services Company had to say about Managing Director Peter Holton:

"*Peter Holton and the Caber Hill team is the most important element of your transaction because for Peter it's not another transaction – it's personal and he deeply cares about his clients. I encourage all who read this to reach out to me and demand to know the specific reasons that support these bold statements, and I will gladly do so because the reasons are too numerous.*"

- President of Horizon Services Company

Learn more at caberhill.com
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