WHITE PAPER

On The

U.S. CONTRACT SECURITY INDUSTRY

MARKET ✦ MARGINS ✦ MERGERS ✦ MULTIPLES

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BY THE NUMBERS

OUTSOURCED AND IN-HOUSE SECURITY INDUSTRY	OUTSOURCED CONTRACT SECURITY INDUSTRY	REVENUES OF THE 3 INDUSTRY LEADERS	REVENUES OF THE 2 MAJORITY FOREIGN-OWNED INDUSTRY LEADERS
$43bn	$23bn	$10.4bn	$5.9bn

OUTSOURCED SECURITY OFFICERS	COMPANIES IN THE UNITED STATES	AVG. ORGANIC GROWTH OF THE 3 INDUSTRY LEADERS	GROWTH OF THE U.S. MARKET
800k	8k	5%	4%

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MARKET

DEFINING THE U.S. CONTRACT SECURITY MARKET

TREND: A continuing increase in the number of companies moving away from being branded as a guard company or even a contract security company. Rather the companies are using broader terms to describe what they do and the services they offer as a result of an expanding menu of services.

The large professionally run security company today will use terms such as "Security Solutions", "Security Technology", "Integrated Guarding" and other terms to indicate the move to offering more services under the same company umbrella. Note especially, the move by Securitas and G4S to increase revenues in the electronics and technology offerings as a goal to enhance operating margins and position itself for a better long-term relationship with the customer.

This white paper, unless otherwise noted, will report on companies that derive at least 75% of revenue from traditional standing security officer or vehicle patrol services and will variously refer to these type services as "Contract Security Companies", "Outsourced Security Companies", or "Manned Guarding Companies". The expanded menu of services offered by many of these companies are as follows:

- *Standing Security Officer and Vehicle Patrol Services* (at least 75% of the total revenues)
- *Special Event Security*
- *Risk Analysis*
- *Security Consulting*
- *Loss Prevention*
- *Investigators*
- *Background Screening*
- *Facility Design*
- *Roving Vehicle Patrol Services*

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DEFINING THE U.S. CONTRACT SECURITY MARKET

MENU OF SERVICES
(Continued)

- *Concierge Services*
- *Alarm Services and Security Systems Integration* (although many contract security companies do not actually perform these services in-house; they refer this type of work to a "partner" that specializes in providing the product or service).
- *Integrated Guarding -* a term coined by the large national and international companies to describe video monitoring and vehicle patrol in combination with on-site manned guarding; or to take the place of on-site manned guarding.

And most recent new offerings:

- *Drones*
- *Security Robots*
- *Cyber Security*

THE THREE LEADERS SHAPING THE DIRECTION OF THE INDUSTRY

There are now three companies (down from four, as a result of the AlliedBarton/Universal Services of America merger) in the U.S. Contract Security marketplace; each having gross annual revenues in excess of $2 billion.

Two of the industry leaders (Securitas and G4S) are majority foreign-owned and combined, represent approximately 24% of the total U.S. Contract Security Market. Allied Universal is 49% owned by foreign investors.

The combined revenues of these three industry leaders make up almost half of the $23 billion U.S. Contract Security Industry; thus are the ones shaping the future of the industry.

	U.S. Revenue (in bn)	Percentage of Market Share
Allied Universal Security Services	$4.5	20%
Securitas	$3.7	16%
G4S	$2.2	8%
	$10.4	44%
Remaining Market	$12.6	56%
TOTAL MARKET	$23.0	100%

THE THREE LEADERS SHAPING THE DIRECTION OF THE INDUSTRY

Here is an overview of the direction of these three industry leaders:

Revenues are up 5% in the North American Market

Aggressively pursuing an expanded menu of services — most recently to include cyber security and robotics.

Systems Integration and Integrated Guarding Revenues are increasing over 25% per year (for Securitas and G4S).

Expected to move toward a customer "fixed rate" pricing model - a model already being used by several large security companies operating in Europe - that aligns with value added services, and away from the low margin, highly commoditized traditional guarding model based on "man-hours provided" .

On August 1, 2016 — Allied Universal was created through the merger of AlliedBarton and Universal Services of America.

AlliedBarton Pre-Merger

At the time of the merger announcement in April, AlliedBarton had a run rate revenue of approximately $2.2 billion. The company was originally formed when two seasoned security executives partnered with a small California Private Equity Group to buy Spectaguard. The newly formed company went on to buy Allied Security in 2000. It continued to purchase additional large companies, such as Barton Protective with approximately $350 million in revenue (and renamed itself AlliedBarton), and Initial Security with approximately $225 million in revenue. In total, AlliedBarton made approximately 10 acquisitions with combined revenues in excess of $1 billion. AlliedBarton has enjoyed annual organic growth of around 5% - 6%. AlliedBarton had been owned in the majority, by MacAdrews & Forbes (a large Private Equity Group), and the Blackstone Group (one of the largest Private Equity Groups in the world) until its sale to the Wendel Group in December, 2015 for $1.67 billion. The Blackstone Group announced that this sale returned a $500 million profit to its investors.

Ownership:

- Wendel SE 33% *
- Warburg Pincus 33%
- Partners Group 17% *
- Management 17%

Financial Statistics:

- North American revenue $4.5bn (the majority of the revenue comes from the U.S.)
- Synergized proforma earnings $440m

* Fractional shares rounded up

Universal Services of America Pre-Merger

At the time the merger was announced in April, Universal Protection had a run rate revenue of approximately $2.3 billion, but had grown to $2.5 billion by the time the merger became effective August 1st. Universal was established in 1965 and had revenues of about $15 million 16 years ago when it was bought by Brian Cescolini and Steve Jones through a management led buy-out. Universal grew organically and reached a volume of around $350 million in 2008 when it teamed with a mezzanine fund in California to provide short-term acquisition funding, which started its path to becoming a mega security company.

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UNIVERSAL SERVICES OF AMERICA PRE-MERGER (Continued)

Universal later teamed with the Partners Group, headquartered in Europe, for an expanded acquisition line; then with Warburg Pincus for the financial backing it needed for the acquisition of industry giants such as Guardsmark (about $500 million in revenue) and the contract security division of ABM (revenues of around $400 million). In addition to making about 40 acquisitions with revenues totaling approximately $1.5 billion, Universal has grown organically at double digit rates since the management buyout until about 2 years ago when the organic growth rate slowed to around 5% due to redirecting sales efforts to the transitioning of the large acquisitions.

Allied Universal - the Merged Company

According to a *prnewswire* article released on May 03, 2016, the revenues of the two companies at the time of the merger announcement was around $4.5 billion and will operate under the Allied Universal brand. It is expected to produce synergized EBITDA of approximately $440 million (after approximately $100 million of synergy savings). After the exchange of $387 million in cash to equalize ownership holdings, Wendel SE will own approximately 33% of the merged company, Warburg Pincus will also own approximately 33%, the Partners Group will own approximately 17%, with the remaining ownership (approximately 17%) owned by certain managers/executives of Allied Universal. Steve Jones (the CEO of Universal) with be the CEO of Allied Universal; and Bill Whitmore (CEO of AlliedBarton) will serve as its Chairman of the Board.

Direction

If Allied Universal makes its projected EBITDA of $440 million, this will be an EBITDA margin of almost 10%; 3% - 4% higher than what the mega-sized companies in the contract security industry are now showing.

(Continued on next page)

DIRECTION
(Continued)

With three of the largest financial groups in the world backing the company, it has the financial resources to continue growing, which is actually a mandate of the investors. Several hundred million dollars is committed for more acquisitions, as well as organic growth.

New sales will be generated from the manned guarding sector, as well as offering security technology. A recent article in *Security Systems News* said this about Allied Universal's growth in the technology arena, "CEO [Steve] Jones is turning to his next task: ensuring that Allied Universal offers security technology in every market where the company has a presence."

"As Jones pointed out [to *Security Systems News*] that's a lot of markets; Allied Universal is now the largest manned guarding security company in North America with a footprint that includes 'every major market and every major submarket.' While remote video monitoring and other electronic security are already available from Universal [before the merger] in several markets, there are many markets that do not yet have those services available."

Jones goes on to mention in the *Security Systems News* article that Allied Universal will continue the relationship Universal started with a robot manufacturer before the merger. Although not mentioned in the *Security Systems News* article, Allied Universal also has plans to offer cyber security, as this area of security becomes a major part of the menu offerings for the large companies that can afford the investment.

Securitas had $3.7 billion in revenues for 2015 in the North American market. Securitas got its start in the U.S. with the initial purchase of Pinkerton's in 1999. Pinkerton's had over $1 billion in revenues at the time of purchase. Securitas followed with the purchase of Burns, a $1.5 billion company, in 2000; then went on to make about a dozen other acquisitions with combined revenues at the time of purchase of approximately $500 million. At $3.7 billion revenues in North America, Securitas has approximately 16% of the total market. Approximately 1% of the North American revenue growth is attributable to price increases to customers relative to the Affordable Care Act. For the year 2015, worldwide revenues of security solutions and technology were approximately $1 billion, an increase of 38% over 2014. As a further commitment to getting larger in electronics security, on February 2, 2016, Securitas took a bold step into the systems integration and electronic security industry through its $350 million acquisition of Diebold, discussed later in this white paper.

- **Swedish Public Company** – Nasdaq Stockholm

Financial statistics:
2015 compared to (2014):

- **Global Revenue**
  $9.5bn ↑ 5% (↑ 7%)
- **North American Revenue**
  $3.7bn ↑ 4% (↑ 3%)
- **North American Organic Growth** – 5.5% (3%)
- **North American Operating Margin** – 5.6% (5.3%)
- **Earnings Per Share** –
  ↑ 8% (adjusted for changes in exchange rates) the largest increase in Securitas' history

Source: Securitas 2014 and 2015 Annual Report

Direction

Alf Göransson, the CEO of Securitas, states in the 2015 report to shareholders the following regarding Securitas' direction:

- Securitas continues to use Technology to increase its earnings and reshape the industry.
- During 2015 Securitas launched Group Vision 2020 – an initiative intended to shape its strategy to become stronger and more sustainable going forward.

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DIRECTION (Continued)

- Group Vision 2020 moves Securitas into a specialists in protective services based on people, technology and knowledge – whereby it will continue to invest and play a leading role in combining guarding services with electronic security and actively pursue organic sales growth in security solutions and technology.

- Securitas has projects in place that will accelerate electronic security, remote guarding and monitoring services, improve differentiation through highly specialized customer segments, expand fire and safety services, and invest and grow in corporate risk management.

- In a longer perspective, Securitas plans to transform the security industry by identifying and pursuing significant new opportunities and by keeping an eye on the future, for example with respect to the use of robotics and drones.

G4S had $2.2 billion in revenues for 2015 in the North American market. It had global revenue growth in 2015 of 4%. The emerging markets represented by Africa, Asia Middle East and Latin America now make up 35% of G4S' global revenues (up from 33% in 2014). Approximately 8% of its global revenue comes from its security systems and technology group. G4S made its initial entry into the U.S. with the purchase of Wackenhut in 2002. At the time of purchase, Wackenhut was billing approximately $2.8 billion. Since that time, G4S has had very attractive organic growth and, starting in 2013, has divested some of the traditional standing security officer business around the world (with aggregate revenues of approximately $1 billion). As we go to press with this white paper, G4S announced that it is in the process of selling its G4S Israeli business at an estimate of 6-7 times G4S's EBITDA. The revenues from this division are reported to be about $100 million (NIS converted to USD). G4S has limited its acquisition activity in the U.S. security market to mostly electronics and high-end investigative type companies. It has concentrated most of its recent acquisition activity in the emerging markets, soon to represent 50% of its total revenue. At $2.2 billion in North America, G4S has approximately 8% market share.

- **London and Copenhagen Stock Exchanges**

Financial statistics:
2015 compared to (2014):

- **Global Revenue**

  $9.1bn ↑ 4% (↑ 5%)

- **North American Revenue**

  $2.2bn *↑ 5.8% (↑ 6.9%)

- **North American Organic Growth** – 5.8% (6.9%)
- **North American Operating Margin** – 6.6% (6.5%)
- **Underlying Earnings Per Share** – ↑ 14% (↑ 14%)

* Net of adjustments for businesses divested

Source: G4S 2014 and 2015 Annual Report

Direction

Excerpts from G4S' 2015 Annual Report to the shareholders:

- G4S continues to invest heavily in new services and new markets that's driving its top line, as well as margin, growth in offerings such as:
  - Proprietary security systems such as AMAG and Secure Connect access control systems

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DIRECTION
(Continued)

- Video and intelligent cameras
- Visitor management systems
- Global security intelligence systems such as GIS
- Software tools, including incident management, and travel advisory systems (an app that identifies the dangerous spots for frequent travelers)

- It continues to strengthen and provide financial support to improve customer service, innovation and sales and business development capabilities.
- It plans to sell more complex solutions which tend to have longer contract terms and higher margins.
- It plans to implement a more efficient organization design, management delayering, lean operating processes, efficient reporting and assurance processes, upgraded IT systems and efficient procurement.

SIZE OF THE INDUSTRY — REVENUES AND NUMBER OF COMPANIES

TREND: Two of the industry reporting agencies are mostly in agreement on the size of the market (currently about $23 billion with adjustments) and the prospects for the future. There will be real growth in the overall market figures, coming primarily from companies converting from "in-house" to contract security.

The latest Freedonia report puts the U.S. "Guarding" market at $23.5 billion in 2019, but this is for manned guarding only and does not include some of the alarm monitoring and systems integration and management being offered by the larger contract security companies and reported in their total U.S. sales revenues.

The latest IBISWorld industry report (2016) puts the U.S. "Guarding" market at almost $24 billion, but includes some services not traditionally offered by typical manned guarding companies.

For this report, we used the figures of both reporting agencies and made certain adjustments as set forth above in coming up with the current $23 billion estimated market size for the U.S. Contract Security Industry to also include some of the integrated guarding and systems integration revenue for the large companies. The integrated guarding and systems integration have now become a part of the total package of service offerings for the large companies, thus the revenues and billing procedures provide for a lump sum rather than a break out of each service.

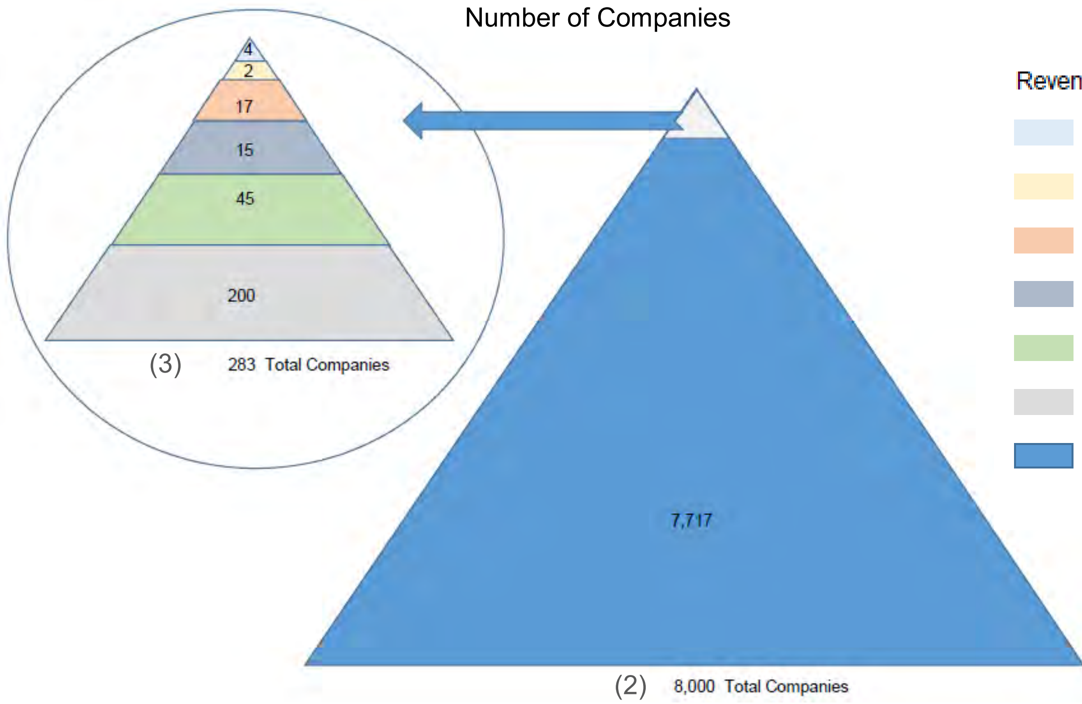
Source of Revenue Increase

Source	Large Companies	Regional and Small Companies
Electronics/Systems Integration	1%	
Smaller Competitors	1%	
New Revenue	1%	1%
Pass Through of Wage Creep	1%	1%
Pass Through of ACA Cost	1%	1%
	5% Growth	3% Growth

Also, both reporting agencies put the growth rate for the U.S. contract security market in the 4% range. This means, again this year, that if the overall market is growing at 4%, but the industry leaders Securitas, G4S and Allied Universal are all enjoying organic growth of around 5%, then some of the 1% difference may be coming from the smaller companies losing customers to these larger competitors.

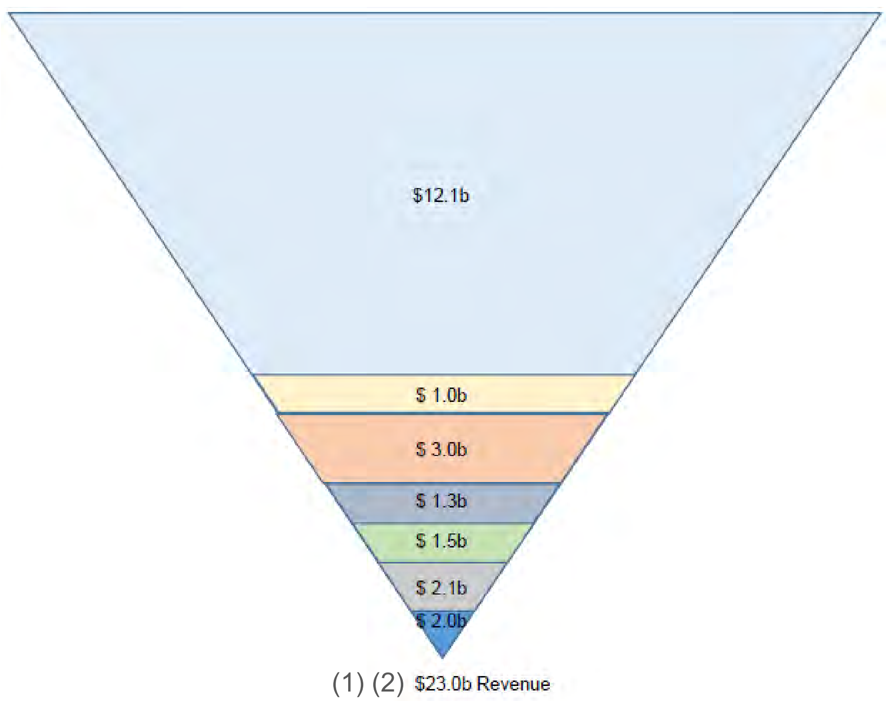
SIZE OF THE INDUSTRY — REVENUES AND NUMBER OF COMPANIES

Number of Companies



Revenue Category	# of Companies
Over $1b	4
$300m - $1b	2
$100m - $300m	17
$ 50m - $100m	15
$ 20m - $ 50m	45
$ 5m - $ 20m	200
$ 0 - $ 5m	7,717
	8,000

Market Size in Dollars



1. Total market size estimated from recent Freedonia and IBISWorld reports
2. Arithmetical function to come to the 8,000 companies and $23 billion revenue
3. Information from files of Robert H. Perry & Associates, Inc. and the *Security Letter*

EMPLOYEES

Number of Employees

It still remains a challenge to find credible information on the number of people working in the contract security industry in the United States.

Therefore, for this report, we go back to a 2 year old ASIS/IOFM survey, which indicated that there are between 1.75 and 1.93 million full- time workers in service of operational security in the U.S. This is an estimate of the number of security personnel fully dedicated to operational security and employed in the private sector. It does not include local, state, or federal law enforcement and refers to the number of individuals hired by organizations to provide security (outsourced and insourced). The figure is a calculation of full-time workers (e.g., two half-time workers are counted as one security employee). Approximately 70% of these workers are security officers; with the remainder in administrative functions or providing other non-operational type services.

Based on the above, with outsourced manned guarding representing a little over 50% of the market, and based on the fact that there are more part-time workers in the outsourced security sector, it's estimated that there are still around 800,000 security officers working in the U.S. Contract Security Industry.

A July 30, 2016 *Wall Street Journal* article titled "Is America Facing a Police Crisis?" indicated that there are approximately 900,000 U.S. public law-enforcement officers. This puts the number of outsourced contract security personnel at about 10% less than the number of public law-enforcement officers.

EMPLOYEES

Compensation

A recent report – "Occupational Employment Statistics" - indicated that the median wages for contract security officers were approximately $13 per hours worked; and $26,000 for full-time gross annual pay. These figures vary significantly depending on the area of the country, union members and whether or not the employees are working at a Federal government facility (where the wage and benefits are mandated by the Federal government contract) vs. a commercial site.

Armed Employees

Based on our in-house records of the hundreds of manned guarding companies with which we have consulted over the past several years, it is estimated that, contrary to public opinion, less than 10% of security officers working for Contract Security Companies carry weapons; and the ones that do today are more thoroughly vetted upon employment and go through extra training to qualify to carry the weapon. Further, many Contract Security Companies hire off duty policemen to fill the posts requiring an armed security officer.

However, as more and more incidences occur that could have been prevented by a weapon carrying security officer, the security customers are demanding that their contract security company find ways to meet this need; while at the same time not creating the undue risk associated with lethal weapons (i.e.; handguns).

Many contract security companies today have responded to this need by equipping certain of their security officer personnel with "Intermediate Services" – a term used to describe "Non-Lethal Weapons". There have been great strides in developing and improving on the non-lethal weapons in use today. Unlike the stun guns of the past, with limited range, these new non-lethal weapons can produce a pepper spray chemical from as far away as 10 feet, with pin point accuracy. Further, these new devices are outfitted with cameras that record every event, to be used as evidence and support of the officer's need to use this type of force to disable the intruder.

THE FACTORS CAUSING GROWTH AND CONTRACTION IN THE INDUSTRY

TREND: The two large industry reporting agencies (Freedonia and IBIS World) predict 4% growth in the industry for the next five years. Also, as mentioned earlier in this White Paper, the three Industry Leaders have enjoyed an aggregate of 5% organic growth, which means at 4% industry growth, the larger companies are winning customers away from their smaller competitors.

GROWTH FACTORS

Below is the source of the growth for new security in the industry – much of the growth coming in the form of "integrated guarding" from existing customers as well new entrants in the outsourced security market:

IN-HOUSE CONVERSIONS - $21 Billion Market

PRESENT CUSTOMERS INCREASING SECURITY

COMPANIES PRESENTLY WITHOUT SECURITY

The move to increase or add security; or make a change in the security provider will be brought about by the following factors:

Cost Considerations

Companies, and more recently, municipalities, looking to cut costs are eliminating their in-house security program and using contract security companies. Typically, in-house security employees will have a higher pay scale due to long term tenure with the company and expensive retirement benefits. By contracting out the security function, companies and municipalities are getting better trained security personnel, in many cases, for less total outlay.

Increasing Crime and Terrorism

Immediately after 9/11 there was a large spike in outsourced security, which eventually settled back down; albeit a much higher level than before the attacks. However, over the past couple of years, the U.S. has experienced a higher crime rate. Murders in Chicago, the nation's third largest city, are presently up about 72%. There's been many new terrorists' attacks on our domestic soil as well as around the world.

THE FACTORS CAUSING GROWTH AND CONTRACTION IN THE INDUSTRY

GROWTH FACTORS (Continued)

Also, there's been a growing number of mass murders in our schools, theatres and shopping malls; and growing concerns over airports, nuclear sites, subways, and sporting events – all having a chilling effect on our nation. All this points to a compelling reason to initiate or ramp up security at these type locations or other locations where large number of people are gathered. All this is adding to a tremendous amount of uneasiness within our country and a need to offer better protection to its citizens.

The Local, State and Federal Agencies are Outsourcing Security Functions

The public police forces are, in most cases, operating on limited budgets, with outdated equipment and a low morale due to the attacks on policemen by our local community. Many insurance companies, as well as municipalities, are now demanding that companies provide adequate protection. The companies that have a need to protect their property and employees will be looking to the outsourced market as a way to respond to this ramped up demand. Many of the larger security companies started preparing for this increase in demand several years ago and are ready to respond. Most of the smaller companies have not been able to afford the training and technology required to handle this type of security, thus may not be in a position to see growth through this ramped up demand.

It is estimated that the largest growth in the contract security industry may be coming from airport passenger screening and other airport security functions presently handled by the Transportation Security Agency (TSA) in most of our airports. There are presently around 20 airports in the U.S. using outsourced security — the largest being San Francisco. However, many other large airports are considering making the change. [See page 59 for more details]

The Need to Upgrade the Security Functions

Many companies today are finding that their in-house force isn't prepared to handle a major crisis. Therefore, they're looking to outsource this function, not only for the cost savings described above, but also to make sure they have the right security in place when it's needed. The contract security company will, in most instances, have better trained personnel and more state-of-the-art technology to handle the security challenges of today. After all, it's the contract security company's goal to have the best and most effective security at competitive prices (the competition makes sure this happens); that's what they do and they have to do it best.

THE FACTORS CAUSING GROWTH AND CONTRACTION IN THE INDUSTRY

GROWTH FACTORS
(Continued)

Enhancing Manned Guarding with Electronics

A recent survey by our firm indicated that many contract security companies today that are actually growing, are doing so by offering systems integration, integrated guarding or some other type of electronic security enhancing services. So far, there hasn't been signs of a large number of customers replacing security personnel with electronics or reducing the guard force significantly.

CONTRACTION FACTORS

Companies Closing

Certain industries adversely affected by the downturn in the economy are closing locations, thereby eliminating the need for security once needed in those areas.

Converting to In-House

Some companies are eliminating contract security and using their own personnel to handle the security functions as a way to justify keeping the valuable employees ... however, the converse of this is true in many instances as mentioned under "Growth Factors" on page 21.

Eliminating Security

Companies adversely affected by the economy are reducing the amount spent on security and taking on the risks of leaving the plant or premises vulnerable to incidents.

Replacing Manned Guarding with Electronics

Some companies are eliminating security officers entirely and replacing with electronic security; and some companies are just reducing the security force and supplementing with "integrated guarding" or other electronic security options. More on this topic under "Manned Guarding vs. Electronics" on the following page.

MANNED GUARDING vs. ELECTRONICS

TREND: The large security companies deriving most of their revenue from the contract security market, especially Securitas and G4S; and now the newly created Allied Universal, continue to invest heavily in technology and other electronic services in order to enhance their position in being a "one-stop" security company able to service most, if not all, of the security needs of its customers.

For several years, the owners of manned guarding companies have been discussing whether electronics could replace guard hours or eliminate the need for a human security officer altogether. But until lately, they have not seen this as a real threat to their business.

However, while the manned guarding industry has been growing in the low single digit range for the past few years, the electronics security industry has been performing somewhat better. While there are no statistics pointing to exactly how much, if any, revenue the electronics industry has taken from the manned guarding industry, there is concern amongst the owners of the traditional manned guarding companies that this may start happening as the manned guarding firm's customers look at ways to trim their security budgets and/or enhance its existing security.

THE ELECTRONIC SECURITY INDUSTRY

Overall, the electronics sector of security is performing better than the manned guarding sector. Michael Barnes, President of Barnes Associates, a well-known and respected M&A firm specializing in the electronic security industry, indicated the following in his popular Industry Overview Report at the Barnes-Buchanan conference (now in its 21st year) in Palm beach in February 2016:

- Total U.S. revenues for the alarm monitoring/service and systems integration companies are now $52 billion – ⬆ 5%
- Total U.S. installation revenue is now $27 billion – ⬆ 4%
- Total U.S. alarm monitoring/service revenue is now $25 billion – ⬆ 8%
- Some of the increase in the alarm monitoring comes from the MSO's (Multiple Service Offerings – the telecoms/cablecoms) entering the market. The MSO's now account for about 5% of the total electronics security market – up from 4% in 2014.

MANNED GUARDING vs. ELECTRONICS

ELECTRONIC SECURITY (Continued)

Many of the telecom/cablecom and internet giants making up the MSO's such as AT&T, Time Warner, Comcast, Comporium, Cox and Direct TV have entered the home electronics security market and there have been recent news articles indicating that others are considering this move as well – a natural progression for these conglomerates to expand their service offerings for their millions of customers. Experts in the industry are saying that this could indicate a game changing event for the electronics security business. One scenario is that they would have to partner with the existing electronics companies to handle the installations, service and response [which we see already happening], which could actually be good for some of the existing electronics companies; while others are saying that these companies have a very large band-width that takes competing in the electronics sector to a whole new level and that would be concerning.

The question in the minds of owners of traditional manned guarding companies is: will these electronic security companies eventually expand their services to the corporate and small business market as well, thereby taking revenues from the contract security companies? Some feel that the flurry of acquisitions and aggressive marketing activities of the electronic companies will make the public more aware of the need for security, thus driving more business toward the already established manned guarding companies; others feel that these electronic companies offer cheaper and sometimes more effective security thus a viable option to manned guarding.

Mitigating the Concern

However, the concern that electronics will replace manned guarding hours are being mitigated somewhat by the fact that the industry experts and the customers, to a large extent, are recognizing that an effective security program usually involves both electronics and manned guarding – an electronic device (such as a video camera) to record what happened and who did it and a security officer nearby to defuse the incident. As mentioned earlier in this white paper, the industry leaders have been preparing for this eventually for several years by investing heavily in technology equipment and making acquisitions of companies with the technology and human resource talent already in place to handle this expanding menus of services being demanded by their customers – explaining the move of the large industry leaders toward "integrated guarding".

MANNED GUARDING vs. ELECTRONICS

Here is the story of how the industry leaders are making the move from the traditional "bill by the hour", plain vanilla, highly competitive guarding services, to the more effective and customer demanded "integrated guarding" services, which in most instances, carries a higher margin to the security company provider:

Securitas sold off its electronics system integration business, Niscayah, about five years ago, then after finding out that it did in fact enhance the manned guarding business, tried to buy it back. In the buy-back process it lost its chance to acquire the company when Stanley Works outbid Securitas and bought the company for $1.2 billion. On June 5, 2014 Securitas bought a 24% stake in Iverify (www.iverify.net), a state-of-the-art video monitoring center headquartered in Charlotte, NC. Then in an even bolder move, on February 01, 2016, Securitas completed the purchase of Diebold's $330 million (in revenue) North American Electronic Security business.

On December 16, 2013, G4S Technology created a new service and maintenance division in Chicago in an effort to leverage the technology resources it already had in-house. This new business served to combine already established G4S call centers and hosted video monitoring centers in other parts of the U.S. In addition to its security business (monitoring and installation), G4S Technology has a telecom division.

On December 4, 2013, Universal, purchased THRIVE Intelligence, a state of the art monitoring center headquartered in Dallas, Texas. Through this Thrive monitoring center, and already established systems integration division, Universal will now greatly enhance its "integrated guarding" revenues as it rolls out this service to its more than 6,000 customers created in the merger with AlliedBarton.

In a recent interview with *Security Systems News*, Steve Jones, the CEO of Allied Universal, said, "Allied Universal is actively seeking acquisitions of security installation companies that will enable Allied Universal to offer installation and technology in all markets. In markets where acquisitions are not available to help us get started, we'll get into it greenfield (starting up an installation business)."

MANNED GUARDING vs. ELECTRONICS

Where does this leave the small company that has not invested in technology or human talent to offer the "integrated guarding" services?

Some of the smaller companies have already teamed with technology companies that will enable them to joint venture these services, although the smaller company will, in many cases, not be in control of the quality of the service being provided, thus jeopardizing its relationship with the customer.

Many of the small companies are servicing customers that do not presently need integrated guarding and/or will not have a need for this service in the future. These companies will continue to be successful in providing personal service oriented traditional manned guarding services.

MARGINS

MARGINS AND PROFITS

TREND: The gross margins (profit at the site level) have been trending down for the past five years, but have now leveled off; albeit at a much undesired lower level. This downtrend in margins has been brought about through competitive pressures and increased direct costs. The Profit line shows insignificant change for the regional and national/international companies, but a drastic negative change for the small company.

In today's competitive environment customers are asking for more and better security, but expecting to pay less. Hence the progressive security companies are finding ways to meet these needs at the customer's price point by getting more efficient and coming out with service offerings that differentiate them from their competitors; such as "integrated guarding".

But as more and more security contracts are being awarded on price instead of quality service, the effectiveness of security as the public has grown to appreciate it may diminish. The industry- wide improvements may become much more difficult as the companies have less profit to reinvest in new technology.

The margins for the small and medium sized companies are usually better than the margins for the large national and international companies

Typically, the well-run, closely-held, small to medium sized contract security company, will have better margins than its larger competitors. The reasons are:

- The smaller contract security company is selling personalized service from the owner and many customers are willing to pay extra for this personalized attention.

- The smaller contract security company operates in a limited geographic area or region; thereby cannot service or attract the larger customers with multi-national or international sites. These "national accounts" are mostly handled by the larger national or international security companies; but the competition to win these types of customers is very intense. Therefore, the large security companies will bid these accounts at much lower margins (than the smaller companies are getting for their "local" accounts) in exchange for a larger volume of revenue, the prestige of providing security for some well-known conglomerate, or the possibility of obtaining additional sites or other types of security for this conglomerate at much higher margins once the security company gets its foot in the door.

MARGINS AND PROFITS

On page 32 is a chart showing the typical margins for the small, regional and national/international U.S. contract security companies – with an insignificant portion of the revenue coming from the governmental sector (typically very low margin business). There is no margin or profit information published for the industry. The information was prepared based on a limited number of financial reports we examined, along with interviews with owners of contract security companies across the U.S.

The chart indicates a decrease in site level profits over the past few years of approximately 4%. We see a larger decrease in areas that have recently been unionized as unions force the company to pay union dues and mandate expensive employee benefits. The overwhelming majority of the owners of the small companies feel the margins will only get worse due primarily to competition from the larger companies.

All companies are presently experiencing or anticipating increases in direct costs due to the following factors

Wage creep – without a corresponding pass through of the cost to the customer. Although this may be a rising cost factor, most companies see this as a viable alternative to the much more expensive high turnover of the security officer force. However, recently, due to unemployment rate drops in many metropolitan cities, the wage creep factor has been more prevalent than in other times in the recent past. More and more companies are having to hire at higher pay rates just to attract a qualified security officer and the increased pay, in most instances, cannot be passed on to the customer in the form of a higher billing rate.

This was confirmed through a recent survey conducted by our firm where the majority of the respondents indicated that the recruiting function was getting more difficult due to the lack of qualified labor – thus having to increase the starting pay rates, without a corresponding increase in billing rates to the customers.

Affordable Care Act – although many companies have made a temporary "fix" in their concerns over the ACA, most companies are concerned about the rising cost in future years, not only in premiums but the cost of administering the plans and meeting all the complicated reporting requirements [See page 50 for a detailed presentation].

MARGINS AND PROFITS

FACTORS INCREASING DIRECT COSTS (Continued)

Increasing Unionization [See page 56 for a detailed presentation]

Increase in minimum wage [See page 55 for a detailed presentation]

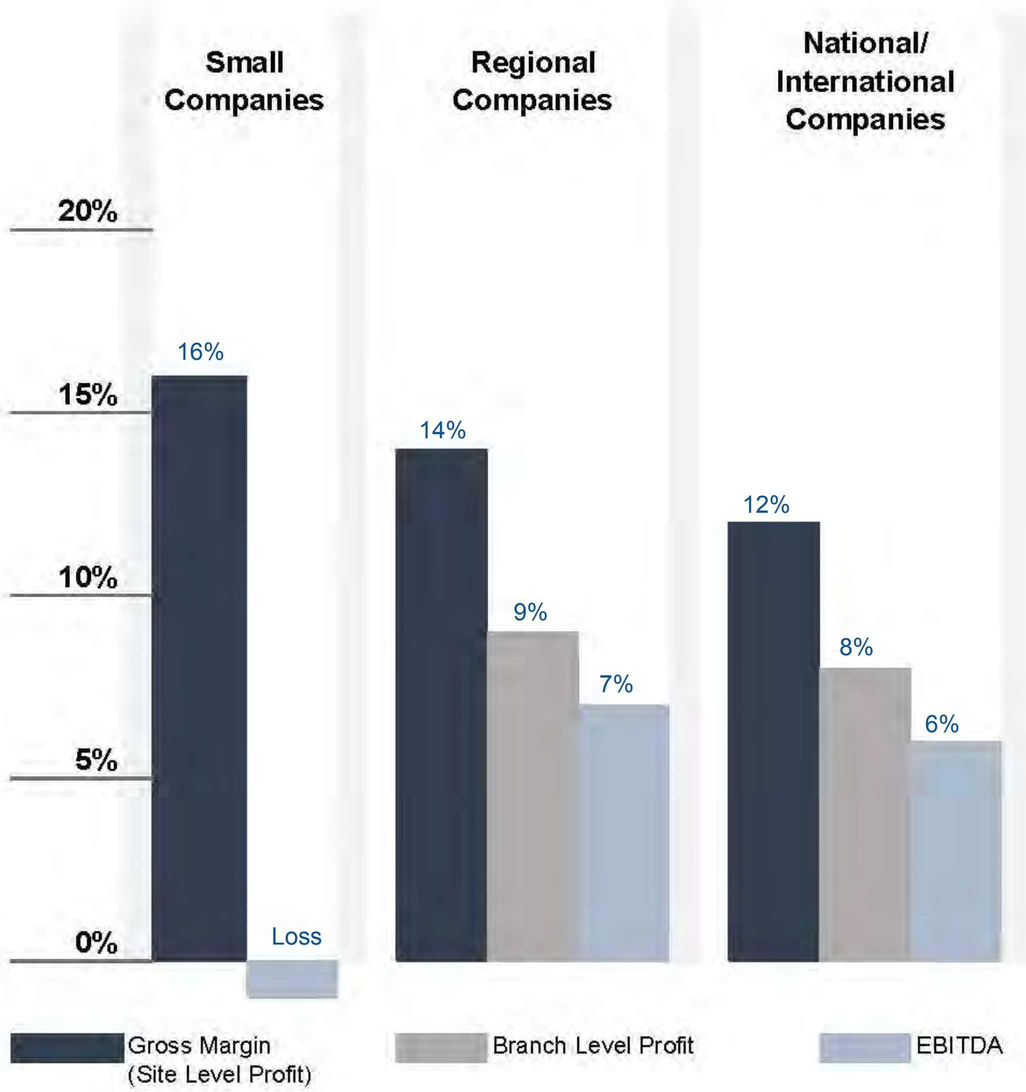
Mandated benefits – some states already have a 3-day sick pay requirement and it's anticipated that this policy will spread throughout the country.

Investment in technology necessary to offer more services to the demanding customers – i.e.; integrated guarding.

It's interesting to note that although the margins at the site level have slipped approximately 4%, EBITDA (Earnings Before Interest Taxes Depreciation and Amortization) has remained relatively steady over the past couple of years for the regional and national/international companies. This is due primarily to a lot of "belt tightening" at the home office level accomplished by being more efficient in utilizing the non-billable personnel, or eliminating altogether some non-billable personnel through investing in technology. However, the small companies are usually operating at optimum levels of overhead personnel already and do not have much room for decreasing operating costs; hence the reason we are seeing the EBITDA decreasing significantly for these smaller companies.

MARGINS AND PROFITS

Margin, Profit and EBITDA



Gross Margin (site level profit) - the billing to the customer less all costs assigned to the site, such as: compensation for the billable officer, wages for the dedicated non billable supervisor (if any), uniforms, employer payroll taxes, workers compensation insurance, general liability insurance, employer portion of health benefits, cost of equipment dedicated to the site, union cost, cost for non-billable roving supervisors if there are a lot of “cold start” sites, etc.

MARGINS AND PROFITS

MARGINS, PROFIT AND EBITDA MATRIX (Continued)

Branch Level Profit - the profit at site level less all the cost to operate the branch office (for companies with multiple branch offices) such as: all non-billable personnel in the branch, office lease cost, telephone, supplies, etc.

EBITDA - Earnings Before Interest Taxes Depreciation and Amortization.

Small Companies - Revenues less than $10 million; owner manages the business and has customer relationships; operates from one office. Usually inefficient in back-office operation and pays more on a per-unit cost for insurance, uniforms, etc. In addition to the previously mentioned cost increases, gross margins are slipping due to the larger companies' recent interest in the smaller accounts, which typically have higher margins. Adding to the gross margin erosion for the small company have been the pricing pressures from the customers and competition. Many of the smaller companies (revenues to $50 million) are now losing customers to the larger companies on national bids, where the smaller companies can't compete.

Regional Companies - Revenues $10 - $100 million; owner less involved in customer relationships, operates multi-offices – usually volume is $5 - $10 million per office. These medium sized companies are also experiencing margin slippage due to the previously mentioned costs. Although the margins are decreasing, the EBITDA has remained relatively constant due to a lot of "belt tightening" at the administrative cost level. Some owners are saying they have cut overhead as much as they possibly can without affecting the quality of service to the customers.

The Branch Level profit can be much lower for regional companies with many small offices in areas with an insufficient volume to justify the branch office overhead. This is often found in companies that are expanding through entering new markets, or having to maintain a support office to service a large account with multiple locations.

National/International Companies – as indicated in several places in this white paper report, many of the national/international companies are now investing heavily in electronics and technology as a way to compete in the market place. While the gross revenue line is remaining relatively flat (most reporting 3% or less growth – although the three industry leaders are reporting 5% organic growth), the gross margins are not decreasing as much as in the past due to the move to have more volume in the higher margin security offerings (i.e.; systems integration, video monitoring, "integrated guarding", etc.).

MERGERS

MERGER AND ACQUISITION ACTIVITY

TREND: 2015/2016 was another "moderate activity" period in terms of number of transactions for mergers and acquisitions in the traditional guarding and electronics security industry; not only here in the United States, but around the world, as well.

In fact, both 2014 **and** 2015 (as well as 2013) were "moderate activity" years, in terms of number of transactions, when compared to the robust acquisition activity for 2012; which boasted an increase of worldwide transactions of 52% over the 2011 year and 74% over 2010.

However, the 2015/16 period was anything but moderate in terms of size of transactions and transactions significant to indicating the direction in which the industry is headed.

Of particular significance:

The AlliedBarton/Universal merger that became effective on August 01, 2016 is the largest merger of two U.S. headquartered contract security companies in history.

The amount invested in the security industry in 2015/2016 was over $10 billion – the largest investment in a single year history of mergers and acquisitions in the security industry; and the Private Equity Groups making these investments are promising more participation in both the electronics and contract security company sectors.

The acquisition funds came from groups previously not in the security space such as:

- Wendel Group — A 310 year old public French investment firm
- Apollo Global Management — One of the largest equity firms in the world with over $160 billion of investments under management
- Koch Equity Development, LLC — Part of Koch Industries, one of the largest privately-held business in the U.S. with estimated annual revenues as high as $115 billion.
- Warburg Pincus — One of the largest private equity firms in the world
- Partners Group — One of the largest private equity firms in the world

MERGER AND ACQUISITION ACTIVITY

The aforementioned investment firms, along with the firms already invested in the Contract Security Industry, have committed to making over $1 billion additional investments in their portfolio companies to be used for acquisitions, as well as aggressive marketing efforts for organic growth.

FOLLOWING ARE THE ANNOUNCEMENTS OF THE LARGE COMPANY TRANSACTIONS IN MERGER AND ACQUISITION ACTIVITY AROUND THE WORLD IN 2015 THROUGH THE 7 MONTHS ENDED AUGUST 1, 2016

Manned Guarding Transactions 2015 through 7 months ended August 1, 2016:

U.S. Transactions:

February 2015 – ***Universal Protection Service acquired two SMS Holdings Corp. security services companies — Valor Security Services and Brantley Security Services.*** The Valor acquisition put Universal in the number one position of providing security to shopping malls throughout the U.S. With the revenue Universal already had in place, coupled with other acquisitions in this sector, the Valor purchase gave Universal over $300 million of revenue in the shopping mall vertical market.

July 2015 - ***Warburg Pincus, with over $35 billion in assets under management, buys controlling interest in Universal Protection from Partners Group***. A July 7, 2015 Moody's investor report indicated a $1.21 billion debt instrument. This along with rollover equity from the existing partners is to be used to buy controlling interest in Universal and buy Guardsmark.

July 2015 - ***Universal Protection buys Guardsmark.*** Guardsmark, with revenues of approximately $500 million and a customer following of mostly Fortune 500 companies, was one of the most respected companies in the contract Security Industry. This acquisition put Universal past the $2 billion in revenues mark.

October 2015 - ***Universal buys ABM's manned guarding business.*** The ABM contract security business is a division of ABM (NYSE:ABM), a multi service, facilities management company with combined revenues of approximately $5 billion. The manned guarding division had revenues of approximately $400 million and was sold to Universal for $131 million - pretax.

MERGER AND ACQUISITION ACTIVITY

MANNED GUARDING
U.S. TRANSACTIONS
(Continued)

December 2015 - ***The Wendel Group buys AlliedBarton ($2.2 Billion in run rate revenues) from the Blackstone Group.*** The deal was first announced in June and was finalized in December. Wendel paid 11.67 time EBITDA - most say a premium for a manned guarding company in today's market environment. The Wendel Group is a different type of buyer than most Private Equity Groups that have made investments in this space in the past. Wendel, a leading European listed investment firm established in France in the early 1700's, does not have a time line for holding its investments. Most private equity groups (such as Blackstone) have an investment window of 5 - 7 years; after which, they usually sell the business and return the profits to the investors in the fund. See below for the link to the details on the merger of AlliedBarton with Universal Services of America.

March 2016 **–** ***U.S. Security Associates acquires McRoberts Protective Agency*****.** Although this transaction was not significant in terms of size (reported as $60.7 million in revenue in the June 2015 issue of the Security Letter's top U.S. manned guarding companies), it was significant in terms of its heritage. McRoberts was established in 1876, and carried the distinction of being the oldest security company in the U.S. until its sale to U.S. Security. Smith Protective, headquartered in Dallas, Texas was established in 1903 and now moves to the number one spot.

August 2016 — ***AlliedBarton Security Services and Universal Services of America merged to form Allied Universal, a security services and solutions company.*** The new organization, with more than 140,000 employees, is now the largest security services company in North America. Allied Universal, www.aus.com will maintain headquarters in Santa Ana, CA and Conshohocken, PA and is expected to have annual revenues of approximately $4.5 billion.

Foreign Manned Guarding Transactions:

July 2015 – ***GardaWorld entered into a binding agreement for the acquisition of Aegis Group*** As the first phase of its strategic expansion, GardaWorld has entered into a binding agreement for the acquisition of Aegis Group, a provider of specialized protective services with annual run-rate revenues of over CAN$450 million with a presence across 10 African and Middle East emerging markets.

MERGER AND ACQUISITION ACTIVITY

Electronics Security Transactions 2015 through 7 months ended August 1, 2016

U.S. Transactions:

March 2015 **– *Third-party monitoring giant Monitronics has acquired LiveWatch Security for $67 million.*** LiveWatch brings to Monitronics over $900,000 in RMR and 32,000 accounts. Its customers are located in all 50 states and Puerto Rico.

April 2015 – ***Imperial Capital Group of Toronto acquired Ackerman Security of Atlanta.*** Imperial Capital, partnered with OPTrust on the deal. Ackerman is a platform company for Imperial and has RMR of more than $3 million and gross revenues of $60 million through its over 100,000 customers, of which 80 are residential. It also serves national accounts in 48 states and Puerto Rico.

May 2015 - ***Apollo Global Management buys Protection 1 and ASG***; then merges the two companies under the Protection 1 brand. Apollo boasts $163 billion under management, making it one of the largest investment firms in the world. The combined revenues for Protection 1 and ASG are approximately $650 million, with approximately $40 million of RMR. See the February 2016 announcement below where Apollo is buying ADT, which will be combined with Protection 1.

February 2016 - ***Securitas acquires Diebold's North American Electronics Business***. Diebold's revenue for this division was approximately $330 million. The purchase price was approximately $350 million, excluding debt, but including normal working capital. The multiple was about 11 times EBITDA. This acquisition is consistent with Securitas' worldwide strategy of increasing its technology as part of its total security offerings.

February 2016 - ***ADT to be acquired by Apollo Global Management*** (see Apollo's purchase of Protection 1 and ASG above). ADT will be merged with Protection 1. The combined companies will boast revenues of over $4.2 billion with Recurring Monthly Revenue of $318 million. The Wall Street Journal reports that this will be one of the biggest leveraged buyouts - takeover of a company using debt - in recent years. This transaction was approved by the shareholders of ADT on April 22, 2016.

Significant Electronic Transactions in process:

January 2016 - ***Johnson Controls in advanced talks to acquire Tyco***. This is more about a merger of manufacturers of security products than security services, but nonetheless has significant implications to the entire security industry, if completed. The transaction is expected to close in October of 2016.

PRIVATE EQUITY GROUPS INVESTING IN THE CONTRACT SECURITY INDUSTRY

TREND: Private Equity Groups that previously were not invested in the contract security sector are now viewing this segment of the security industry as an attractive placement for their managed funds.

Private Equity Groups are firms made up of executives and MBA's with an attractive track record in finding, buying and managing (either passive or active) struggling or fledging companies needing the financial resources to take the company to the next logical level. The investors in these firms are primarily very large pension funds, insurance companies, high net worth individuals, family partnerships, municipalities, the members of the Private Equity Group and usually the owner of the company they are buying.

According to the Private Equity Growth Capital Council, there are more than 3,300 private equity firms in the United States that own more than 11,000 businesses, which employ roughly 7.5 million people.

Collectively, the Private Equity Groups raised a very large amount of commitments during the years 2005 – 2007. Those commitments were put to work buying companies and many have recently been divested in accordance with the PEG's commitment to return the profits (usually after about 10 years of establishing the fund). Much of these profits, as well as new investments have been redirected into new funds.

According to a New York Times article on November 30, 2015 (written by Lis Moyer) - "Adding investments in traditional funds and shadow capital together, the private equity market will attract a record $629 billion this year (2015). Investors have money to put back to work after being paid for earlier private equity investments and the increase also reflects a bit of a backlog in committed but not invested money. This "dry powder," as funds call it, is up 23 percent, to $1.3 trillion since the beginning of 2015 as private equity funds hold off on acquisitions but investor money keeps pouring in."

PRIVATE EQUITY GROUPS INVESTING IN THE CONTRACT SECURITY INDUSTRY

Traditionally, the PEG’s interest in the security sector was mostly centered around the biometrics and electronic security businesses because these companies carried larger margins, with less liability, than the traditional manned guarding companies. As presented on page 35, new PEG’s making investments in the electronic security space have included giants in the industry, such as, Apollo Global Management and The Koch Brothers Foundation. There are indications that these, along with other large PEG’s, may now be looking at the Contract Security Industry—evidenced in part, by a recent Reuters announcement that Apollo is in serious discussions to buy Constellis Holdings, LLC, the owner of the U.S. military security services formerly known as Blackwater (Now called Academi). Although Academi is not the traditional contract security company, this move by large investment companies to have interest in this space sends a signal that more PEG’s will be interested in the traditional Contract Security Industry for several reasons:

1. The recent auction Credit Suisse ran for the sale of AlliedBarton. Blackstone got roughly 12 times adjusted EBITDA – a very respectful price for a service company in today’s market. An article in the *Forbes* magazine right before Blackstone put AlliedBarton on the block, quoted an executive at Blackstone as saying that Blackstone would enjoy a half a billion dollar profit for its 6 years of holding this investment - a very respectful return and one any of the PEG's would be happy to receive for its investors.

2. The increase in the crime and terrorists rates have indicated a real growth in the security industry for the next few years. The public police force, in many instances, is maxed out on its ability to handle the uptick in this activity and does not have the expertise and equipment to handle the special situations inherent in this type of protection. The large industry leaders have been investing heavily in the technology necessary to handle this type of security.

3. The recent track record of the industry leaders, all with increased revenues and margins, point to a lucrative investment model for investors looking for better returns than today's low rate options have to offer.

PRIVATE EQUITY GROUPS INVESTING IN THE CONTRACT SECURITY INDUSTRY

The Private Equity Groups that presently have investments in the contract security industry are presented below – all the groups have been and remain very active in buying smaller, tuck-in companies; a trend that will continue and probably accelerate in the next twelve months. It's important to note that the annual revenue from the contract security companies owned by these Private Equity Groups amounts to approximately $6.2 billion and represents approximately 27% of the total U.S. Contract Security Industry.

Company	PE Partner	Date Invested	Overview
U.S. Security Associates	Goldman Sachs	July 2011	Goldman Sachs has a significant investment in U.S. Security Associates - approximately $1.4 billion in annual revenue. Goldman Sachs purchased WindPoint Partners' ownership on July 29, 2011.
UAS	LaSalle Capital	April 2010	LaSalle Capital started United American Security LLC in April 2010, through the simultaneous purchase of 3 existing companies - Industrial Security, Inc., Leonard Security Services, Inc., and Eagle Security, Inc.; and has since grown to be a significant player in the Contract Security Industry through several tuck-in acquisitions and today enjoys annualized revenue of approximately $65 million.
SOS	ZS Fund L.P.	December 2012	ZS Fund entered the contract security industry in December 2012 with a major investment in SOS Security. Since then, SOS has made over a dozen tuck-in acquisitions, as well as enjoyed attractive organic growth and is billing around $200 million per year.
AlliedUniversal Security Services	Wendel; Warburg Pincus; Partners Group	August 2016	All three of the Private Equity Groups are co-investors and own collectively about 87% in the recent Allied Universal merger - billing around $4.5 billion per year.

THE M&A OUTLOOK

As for the large public international security companies such as Securitas and G4S, we haven't see much activity in buying plain vanilla guarding companies from these mega conglomerates in 2015, or 2016 to-date, anywhere in the world. They are enjoying continued and sustainable top line and bottom line growth through promoting their integrated guarding and cyber security success, which is enhancing their organic growth trend. They will continue to curtail their buying activities; unless opportunities arise in the non-traditional security sectors, such as large high-end systems integration companies or opportunities to leverage their integrated guarding efforts.

We see continued growth pressures from the contract security companies partnered with Private Equity Groups (PEG's), evidenced by the fact that they are getting more aggressive in targeting select acquisition candidates and are pursuing the relationships aggressively. The security companies owned in the majority by the PEGs are getting pressure to maintain at least 5% (and some even more aggressive) net growth and they are sitting on a huge stash of readily available funds that can make this happen. There is presently over $1 Billion in "dry powder" set aside by the active PEGs for acquisitions in the contract security and system integration markets.

This growth can't happen organically. Take the recently formed Allied Universal company as an example: given that the average attrition rate for large companies is somewhere in the 8% range, at almost $5 billion in gross revenue, Allied Universal would have to sell $650 million of new business just to maintain the 5% net growth – a very daunting, if not impossible, task without the help of some significant acquisitions.

MULTIPLES

OVERVIEW OF LARGE CONTRACT SECURITY COMPANY TRANSACTIONS

The following summarizes the large *announced* sale transactions for the past 6 years of U.S. security companies offering primarily contract security officer (guarding) services. To view large transactions dating back to 1999 in our previous White Papers, please visit the Publications Archive on our website.

	Company Sold	Buyer	Revenue	EBITDA	Price	Price as Multiple of Revenue	Price as Multiple of EBITDA
2010							
(1)	PARAGON SYSTEMS	PINKERTON GOVERNMENT SERVICES	$140M	N/A	$34.5M	25%	N/A
2011							
(1)	Security Consultants Group	PARAGON SYSTEMS	$106M	N/A	$22M	21%	N/A
(2)	U.S. SECURITY ASSOCIATES	Goldman Sachs	$765M	N/A	N/A	N/A	N/A
2012							
(3)	ANDREWS INTERNATIONAL	U.S. SECURITY ASSOCIATES	$350M	N/A	N/A	N/A	N/A
2013							
(4)	IPC INTERNATIONAL	Universal Protection Service	$130M	N/A	$24M	18%	N/A
2015							
	VALOR / BRANTLEY SECURITY SERVICES	Universal Protection Service	$130M	N/A	N/A	N/A	N/A
	ALLIED BARTON SECURITY SERVICES	WENDEL	$2.2B	$150M	$1.67B	80%	11.67x
	GUARDSMARK	Universal Protection Service	$500M	N/A	N/A	N/A	N/A
	ACSS American Commercial Security Services	Universal Protection Service	$400M	N/A	$131M	33%	N/A
2016							
(3)	ALLIED BARTON SECURITY SERVICES / Universal Protection Service	WARBURG PINCUS / WENDEL / Partners Group	$4.5B	$440M	N/A	N/A	N/A

See Foot Notes on Next Page

OVERVIEW OF LARGE CONTRACT SECURITY COMPANY TRANSACTIONS

FOOTNOTES TO PAGE 44 (Continued)

1) These are the only announced transactions for a major provider of security services to the Federal Government. Typically, the margins for Federal government accounts are less than traditional commercial accounts, thus the selling multiple as a percent of revenue is less than the industry average for traditional commercial accounts.

2) WindPoint Partners sold its equity portion to Goldman Sachs. The revenue amount shown is from the July 2011 issue of The Security Letter.

3) These transactions were announced as a merger. The EBITDA figure for Allied Universal ($440m) is estimated based on proforma synergies.

4) IPC was sold out of Chapter 7 Bankruptcy. Universal purchased the accounts and goodwill; and assumed certain contingent liabilities.

SELLING PRICES FOR LARGE CONTRACT SECURITY COMPANIES

Most of the large transactions announced over the past 15 years, indicated average purchase price values in the 8 – 9 times EBITDA range (excluding Universal's purchase of IPC, which was bought out of Chapter 7 bankruptcy and was not an "enterprise value" purchase). However, the acquisition of AlliedBarton by the Wendel Group exceeded these averages coming in at almost 12 times EBITDA and 80% of annual revenue; which underscores the higher valuations being paid for large and small contract security companies today.

In the case of Private Equity Groups buying a large contract security company as a way to enter the market, the multiples paid were at least as high as what the industry buyers were paying, even though the PEG'S return on investment in the short term was not as attractive as the industry buyers were enjoying. However, the PEG's had to be competitive in the bidding process for the initial buy. As the PEG's made future acquisitions through the flagship company, their returns became a lot more attractive, especially if the acquired company folded into the flagship company's operations – thereby through averaging the prices paid for the multiple purchases, the return on the initial purchase became a lot more attractive.

Will there be more large company acquisitions in the near future?

We predict that there will, in fact, be more large company acquisitions coming from the very aggressive Private Equity Groups. As previously mentioned, the manned guarding industry is starting to get the attention of some of the Private Equity Groups that before now had no interest in this space. As the PEG's track the performance of some of the large companies, the interest in this space will be enhanced. The PEG's that do not presently own a security company, but are looking to make a commitment in the space, will be competing with the well- funded PEG's already in the space for just a few "flagship" size companies left in the industry.

Also, a large contributing factor to more large company acquisitions is the need for companies like the recently merged Allied Universal company to keep growing to please its investors. It needs to maintain at least a 5% growth in order to stay in favor with its investors; which means it will have to make some very large acquisitions coupled with attractive organic growth. Consider this, and as mentioned earlier on page 42, the average customer attrition rate for the large company today is around 7 – 8%. This means that if a $5 billion company needs to have a net growth of 5%, it has to generate a 13% revenue increase ($650 million) – through organic sales and/or acquisitions – a very daunting task if some of the acquisitions are not significant in revenues.

SELLING PRICES FOR SMALL CONTRACT SECURITY COMPANIES

SELLING MULTIPLES

The prices being paid for the smaller companies over the past few years, expressed as a percentage of annual revenue, are about the same as the larger transactions; except for the AlliedBarton/Wendel transaction, which came in at 80% of annual revenue – exceeding the averages for the smaller companies. The multiples of the **sellers'** reported EBITDA are still higher for the smaller transactions than the larger transactions, since the buyers in the contract security industry (unlike most other industries) give the seller credit for the redundant cost savings that benefit the buyer in the transaction.

For many years, and unfortunately even today, many owners thinking about selling were using the traditional "street formulas" as a way to estimate the eventual selling price of the company. These "street formulas" are based on multiples of gross units (percentages of gross annual revenue or multiples of gross monthly billing), irrespective of the actual earning potential of the company, and are often used as a way to put an estimated value on the company. However, these street formulas usually result in the company being grossly over-priced or, worse yet, under-valued. When we look at the transactions we've managed over the past few years for companies with volumes between $5 million and $150 million, the selling multiples, as a percentage of annual revenue, were as low as 20% to as high as 50% or **more** of revenue, for just the accounts (i.e.; if the buyer purchases the balance sheet items, these items are added to the price based on the balance sheet carrying value) – thereby supporting the fallacy of valuing the company on gross units.

In fact, the "street formulas" were never used by the experienced buyers. These experienced buyers today are buying profit, not gross revenue and they're paying more for it; they're buying the accounts based on a multiple of the profit at the site level (which determines the buyers' economic return on the acquisition) and that multiple is adjusted depending on: the attractiveness of the accounts, quality of management going with the sale, geographic location of the accounts – and several other characteristics important to buyer prospects.

SELLING PRICES FOR SMALL CONTRACT SECURITY COMPANIES

The multiples the buyers are paying for the small contract security companies have increased 50% over the past 5 years

The multiples (of cash flow) the buyers are paying for the small companies today are at an all time high, but this doesn't necessarily mean the total selling prices have increased for all these sellers. As the revenue and/or gross margin of many of the small companies have dropped, the selling price has remained steady or decreased since the higher multiple is applied to a lesser profit. As previously stated, the buyers are buying profit, not gross revenue.

Why buyers are paying higher multiples

Since the LIBOR rate (the rate world banks charge their most credit worthy customers to borrow money) has been declining – approaching zero – the large Private Equity Groups (the most active buyers for contract security companies today) are paying less to borrow money and they are passing this savings on to the seller in order to entice the "fence straddlers" to come to the closing table. However, the LIBOR rate has been unsteady in the past few months and some economists say this is a signal that the rate may be moving back up soon.

The Private Equity Groups, that already have investments in the security space, are sitting on a lot of idle cash and they need to put these investments to work quickly in order to satisfy their investors. As mentioned earlier, combined, the PEGs that are presently invested in the contract security company market have over $1 billion set aside for growth and most of it is intended for acquisitions. They're stepping up to high multiples early in the negotiation process so as not to risk the owner losing interest in selling.

SELLING PRICES FOR SMALL CONTRACT SECURITY COMPANIES

Will the multiples of cash flow keep getting higher or is there a “correction” on the horizon?

It is unlikely the multiples will increase. As mentioned above, the LIBOR rate, which effects the offering prices for companies is about as low as it can get; and if it starts to increase, the selling values of companies will decline. Also, the present multiple level is very close to reaching the buyer’s “build vs. buy” model threshold, which means rather than a buyer paying a higher than normal multiple to purchase a company, a robust advertising/marketing campaign to obtain new customers organically may be a more compelling alternative.

THE AFFORDABLE CARE ACT AND THE ANTICIPATED VALUATION OF SELLING COMPANIES

TREND: Owners are still concerned over the long term effects of the ACA—the cost of the premiums as well as the additional administrative cost to implement and company with the reporting requirements.

During the years 2014 and 2015, owners got a chance to discover some of the perils of the ACA. Most owners say that it hasn't been as expensive as originally thought, at least for these two years; but are concerned about what happens in future years as more and more employees decide to leave the expensive exchanges (because of the tax penalties) and go with a company plan. Most of the small companies have experienced 20% or less participation; and almost all the companies have said that around 30% of their customers have agreed to a bill rate increase to offset most, if not all, of the cost increase brought about by the ACA.

Valiant Solutions, Inc., a leading provider of cloud-based Payroll and Human Capital Management (HCM) solutions, recently sent an ACA survey to its more than 200 manned guarding customers ranging in size from 100 to over 6,000 employees. The responses indicated that: 1. About 9% of the guard force elected to take the company coverage 2. The average annual premiums were $4,720 per covered employee – the employee paid $1,950 through payroll deductions, leaving $2,770 for the company's portion of the premium 3. The companies were offering the employees a choice of 3 plans 4. 16% of the security personnel were already covered under union mandated plans.

It's still unclear as to what effect, if any, the ACA will have on the selling prices of the small companies. While there have been many owners to put their company up for sale in the past couple of years because of the concern over the ACA, there still has not been a mad rush to the closing table. We think most of the owners, that are concerned, are still in a "wait and see" mode – hoping for sweeping changes that will eliminate the expense of implementing the plans or an outright repeal of the Act, which most politicians say can't happen.

FACTORS DRIVING OWNERS TO SELL IN TODAY'S MARKET

TREND: Higher operating costs, shrinking margins, increased competition and unprecedented selling multiples are putting owners in the selling mode.

- **Increase in the Federal and state mandated minimum wage** – many states have already enacted increases in the minimum wage to upwards of $15 per hour phased in over the next several years. Owners of the small companies are concerned that this increase cannot be fully passed on to the customer, which results in higher direct cost and more erosion to the operating margin – the profit line the buyers are using as a basis to compute the prices they pay for an acquisition. See "Challenges" on page 55 for a detailed discussion on the increase in minimum wage.

- **Recently enacted provision that raises the threshold for overtime exemption for annual wages paid from $23,660 to $47,476.** Many supervisors and management personnel of small security companies are presently making less than this new annual floor amount. Raising the minimum to $47,476 means higher wage cost to the employer or reducing the hours the supervisor works – either option another "hit" to the company's already depressed profits.

- **The cost of implementing the New Healthcare Bill (Affordable Care Act)** - While it's unknown what the exact impact this bill will have on the Contract Security Industry in the long run, most owners think it will definitely mean less profits and loss of customers or billable hours. While owners had to comply with the ACA in 2014, its real impact on the company and industry as a whole is still very much uncertain; which is driving some owners to put their company on the market now. [See page 50 for a detailed discussion]

FACTORS DRIVING OWNERS TO SELL IN TODAY'S MARKET

- **Not being able or willing to keep up with the changes needed to stay competitive in today's market.** As we mentioned in the section on margins, the margin at the site level is dropping for most companies – whether small, medium or large. The companies that can (i.e.; the large and medium-sized companies) are compensating by getting more efficient below the site level line. They are reducing clerical labor and non-billable overtime percentages by investing in technology that enables them to run the company with less people and at the same time be more efficient. However, the technology costs money and many owners today, especially those getting close to retirement age, just aren't willing to make the investment that doesn't give an immediate return. Also, the training, tax, and licensing laws are getting much more complicated and in some cases have required an investment in outside consultants, which is another new expense; not to mention the expense that will be associated with complying with the new Affordable Care Act.

- **Small to medium sized companies are losing business to the national account providers** - This trend has been going on for several years and, according to the owners of many of these companies that took part in our recent survey, the situation is getting worse. The large, well-financed, companies are now going after the smaller customers that tend to have better margins. Previously, these customers were too small to be a target for these large security providers. Note in the "Industry Leaders" section of this White Paper that the organic revenues of the "Leaders" increased around 5%, while the total market grew at an unimpressive 4%. This means that some of the increase in revenue for the larger companies is coming from their smaller competitors. This loss of business is causing the owners of the smaller companies to seriously think about selling before more business is lost to the large national companies.

- **Possible lower valuations later -** Many owners feel that the challenges of the future will mean more companies will be put on the market, thereby causing a decrease in the valuations for a future sale.

- **Probable increase in taxes** - [See page 56 under "Challenges and Opportunities for Owners of Contract Security Companies"]

- **Unionization** – [See page 56 under "Challenges and Opportunities for Owners of Contract Security Companies"]

- **Original owners reaching retirement age —** Many contract security companies today were started 30 – 40 years ago, when the trend to outsource security was getting started in a big way. These owners are now reaching retirement age and are looking to sell their business.

WHY OWNERS ARE NOT RUSHING TO PUT THE COMPANY ON THE MARKET

- **Some companies are enjoying increased revenue and profits** - The results of a recent survey conducted by our firm indicated that a small segment of the contract security industry is actually growing in revenue and profits. These are the companies owned by executives who are keeping up with the technological advances in the industry and investing heavily in marketing efforts.

In **Volume 15, No. 1 of our issue of *Notebook of Ideas for Divestitures of Security Guard Companies***, we mention four reasons owners are not putting their company up for sale now:

- **Owners consider the industry recession proof** — contract security company owners see continuing activity in the market, so they are taking a "wait and see" approach to selling, thinking that buyers will still be there when they get ready to sell.

- **Decline in alternative investment opportunities** — Before the recent economic downturn raised its ugly head, many sellers of contract security companies made more money from the funds they invested from the sale of the company than they made while owning and operating the company. However, with the dramatic drop in real estate values, and money market returns declining so dramatically, doing this safely and profitably in the current economic climate would be very difficult. The profits they are making from their company cannot be replaced by returns on the after tax monies invested from the sale of the business.

- **Owners have not yet "tested" their credit lines** — Many of the more fortunate contract security companies established or renewed its credit lines back when the banks were eager to please and more anxious to lend money, and the credit line will not come up for renewal for several more years. Most are still safe with their loan terms and have not actually talked with their bank about what to expect come renewal time. They feel reasonably, but cautiously, optimistic that their banks will continue to support their financial needs.

- **Many companies have already lost value** — Many of the contract security companies have, in fact, felt the effects of this very competitive market and have lost value – not because the selling multiples have gone down, but because the company has lost valuable and profitable revenue. The owners do not want to have to settle for a reduced price because they still have high expectations, so they are hoping their company will get large and more profitable again; at which time they will think seriously about selling.

OUTLOOK

CHALLENGES AND OPPORTUNITIES FOR OWNERS OF CONTRACT SECURITY COMPANIES

TREND: There have been many recent developments that could, and probably will, have a dramatic effect on owners of private security companies.

CHALLENGES

The Affordable Care Act

As mentioned in past White Papers, the ACA is and continues to be a great concern to owners of ALL contract security companies – large and small. The cost of the insurance premiums mandated by the ACA is still a moving target and a big question mark in the minds of the owners of contract security companies. The year 2016 will soon be in the past, but there are lingering concerns as to the number of new enrollees in future years as well as the additional burden and cost of administering the plans and the penalties for non-compliance; even if unintentional.

Increase in Minimum Wage

Several states have announced a "proposed" or already "approved" increase in the minimum wage – some gradually increasing up to as much as $15 per hour; others getting there at a much faster pace. According to a late 2015 release of the National Employment Law Project, "it's been a banner year for the Fight for $15. The movement led by fast-food, retail and other low-wage workers, grew markedly in size and influence. Fourteen cities, counties and states approved a $15 minimum wage through local laws, executive orders and other means in 2015. Dozens more ballot or legislative proposals were introduced around the country, 16 of which will carry over into 2016. And at least 23 notable employers voluntarily increased their minimum pay to $15 or higher in 2015, either through company policy or collective bargaining agreements."

According to the companies in our files and other industry statistics, the average pay rates for security officers on post assignment is in the $12—$13 per hour range. Most companies pay about $3 per hour higher than the local minimum wage in order to attract qualified personnel. A company with a present pay rate of $13 per hour that is forced to meet the $15 per hour law would have to increase the billing rate to the customer by over 20%; and even more if the company wanted or needed to maintain the $3 per hour distance from the lawful minimum wage.

CHALLENGES AND OPPORTUNITIES FOR OWNERS OF CONTRACT SECURITY COMPANIES

CHALLENGES (Continued)

According to the responses we received from a recent survey, a $15 minimum per hour wage rate is one of the largest concerns for large, as well as small, companies that are already facing increase in pay rates without a corresponding increase in bill rates that are due to the recruiting challenges brought about by low employment rates in many areas across the country.

Deeper Unionization of the Contract Security Industry

For some companies the wage rates and benefits mandated by unions are lower than what the company provides its non-union personnel. However, for the vast number of companies, unions increase operating cost, which in turn lower margins.

Continuing Proposals to Increase the Federal Income tax rate on Capital Gains

The heavy Federal deficit is forcing the Federal Government to find ways to bring more money back into its coffers. Unfortunately, the business owners and the high earners will be paying its “unfair” share of helping restore the treasury. In January of 2013, the capital gains rate was increased from 15% to 20%, which has already adversely affected owners selling their company. On top of this, a 3.8% investment tax was imposed making the combined rate 23.8%.

This is a Presidential election year in the U.S. and the Republican and Democratic candidates are proposing changes in the tax structure for capital gains and ordinary income that will effect the amount of taxes owners pay when selling a business.

See next page for a comparison of the two proposals.

CHALLENGES AND OPPORTUNITIES FOR OWNERS OF CONTRACT SECURITY COMPANIES

CHALLENGES
(Continued)

	Ordinary Income	Capital Gains
DEMOCRATIC PLAN	**Top Tax Remains at 39.6%**	**Maintain the present 20%, plus the 3.8% investment tax; however, the investment/asset must be held for at least 6 years in order to qualify. In effect, it starts at 39.6% the first year and drops each year until the rate reaches the 23.8% in the 6th year.**
REPUBLICAN PLAN	**Top Tax Reduced to 33%**	**To remain at the present 20% and one-year holding period. Elimination of the 3.8% investment tax.**

Higher Unemployment and Other Taxes

Owners of large and small companies are still experiencing very large increases in unemployment taxes even though the unemployment rate has decreased over the past year. As state unemployment funds have been depleted during the high unemployment period, the rates are continuing to rise – already approaching double digits in some states.

Also, many municipalities are trying to pass legislation to tax services (not presently subject to sales tax) in an effort to make up for the diminishing tax based revenues. This sales tax is usually passed on to the customer contracting for the security, but it definitely impacts the customer's cost of security, which in turn puts pressure on the customer to ask for price concessions from the security service provider.

CHALLENGES AND OPPORTUNITIES FOR OWNERS OF CONTRACT SECURITY COMPANIES

CHALLENGES
(Continued)

Mandatory Paid Leave

Some states have already mandated paid sick days to all employees and the trend is growing. A June 22, 2015 "New York Times" article indicated that there's …. "New Momentum on Paid Leave, in Business and Politics". The article went on to say that …"Oregon this month became the fourth state to pass a bill requiring that companies give workers paid sick days to care for themselves or family members". The obvious concern to the owners of contract security companies is that this is just one of many new laws being passed that increases the cost of operating a business that probably will not be able to be passed along to the customer.

OPPORTUNITIES

Many owners see opportunities ahead. They are still experiencing growth and have positioned their company to "deal" with the challenges:

The Affordable Care Act

Just as there are concerns over the ACA, as mentioned above, there are also companies that see this as an opportunity: Some owners say the ACA creates a level playing field in the bidding process. Prior to the ACA law, when several companies were bidding on new business; many of the bidders had very expensive healthcare plans and couldn't compete on the cost structure against the companies that were self-insured, or did not provide and/or pay for the employees insurance. With the passage of the Bill, many of the companies that have been disadvantaged in the bidding process feel that this passage will help them win more new accounts as the playing field for new business is now more leveled. (See more discussion on page 50). However, there is still a concern among many owners of small contract security companies that their larger competitors will be buying insurance at cheaper rates because they will be buying in larger volumes or may even be self- insuring.

Many owners feel that the "in-house" security market may now open up as a result of the New Healthcare Bill and overall cost increases in employing workers – especially workers that have been with the company for a long time.

CHALLENGES AND OPPORTUNITIES FOR OWNERS OF CONTRACT SECURITY COMPANIES

OPPORTUNITIES
(Continued)

Municipalities Continue the Trend of Outsourcing its Security Function

A look at the public bid list will reveal that more and more municipalities are looking for ways to contain cost as it's faced with having to raise rates to its customers; and the municipalities are doing it through outsourcing its security functions and in some cases, its police force. Not only is it outsourcing to reduce its cost, but also to get more effective security now being provided by the contract security companies that have invested heavily in technology – something the municipalities have been lax on doing over the past few year because of budget restraints.

Expansion of Private Airport Screeners

The recent move to privatize security screening at airports could create a large market not available to most contract security companies since the TSA was formed after the events of 9/11. In fact, this may be the source of the largest growth for the outsourced contract security industry.

A recent report by ABC News indicates that the TSA agents are failing miserably in carrying out their duties of protecting the traveling public. It reported that undercover agents in the Department of Homeland Security (DHS) successfully smuggled fake explosives and weapons through 67 of 70 checkpoints in a secret nationwide exercise. One of the solutions being considered [and probably the most viable] is to expand the Screening Partnership Program (SPP). Created in 2001, the SPP allows private airport screeners to operate under the oversight of the TSA. Private personnel check bags, screen passengers, and manage daily affairs while meeting the same standards of originally enacted by Congress after 9/11.

The San Francisco airport has been under the SPP program since the inception and is currently at almost $100 million of security revenue, the largest in the system. However, may other large airports are currently seriously considering going with private outsourced contract security companies to handle this function (while still under the oversight of the TSA).

CHALLENGES AND OPPORTUNITIES FOR OWNERS OF CONTRACT SECURITY COMPANIES

OPPORTUNITIES
(Continued)

Security Outsourcing Due to Increasing Crime and Terrorism

Immediately after 9/11 there was a large spike in contracted security, which eventually settled back down; albeit a much higher level than before the attacks. There's been increasing terrorists threats to our country over the past several months, which is reminding many people of what happened on September 11, 2001; and they're concerned that it could happen again.

Also, there's been a growing number of mass murders in our schools, theatres and shopping malls; and growing concerns over airports, nuclear sites, subways, and sporting events – all having a chilling effect on our nation. All this points to a compelling reason to initiate or ramp up security at these type locations or other locations where large number of people are gathered. The public police forces are not equipped to handle the special security expertise required to secure some of these critical infrastructures; therefore the owners are looking to outsource these functions to companies with the experience and technology to handle this type security.

The trend of outsourcing the security function is still growing as the Contract Security Companies are offering a wider menu of services, especially in the electronics security and technology areas.

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We initiate and manage the sale of privately-held security companies. Since 1977, we have represented over 200 owners located throughout North and South America, Western Europe, the Caribbean, South Africa, and the Middle East.

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