



U.S. CONTRACT SECURITY INDUSTRY

White Paper

JULY 2017

9th Edition

MARKET ✦ MARGINS ✦ MERGERS ✦ MULTIPLES

Prepared by:

ROBERT H. PERRY
& Associates, Incorporated

BY THE NUMBERS

OUTSOURCED AND IN-HOUSE
SECURITY INDUSTRY

\$44_b

OUTSOURCED CONTRACT
SECURITY INDUSTRY

\$24.5_b

REVENUES FOR THE
3 INDUSTRY LEADERS

\$11.9_b

REVENUES FOR THE 2
MAJORITY FOREIGN-OWNED
INDUSTRY LEADERS

\$6.6_b



OUTSOURCED
SECURITY OFFICERS

800_k

COMPANIES IN
THE UNITED STATES

8_k

ORGANIC GROWTH FOR
THE U.S. MARKET

5%

TOTAL REVENUE GROWTH
FOR THE U.S. MARKET

6.5%

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MARKET

DEFINING THE U.S. CONTRACT SECURITY MARKET

TREND: Security companies continue to move 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 word combinations to indicate the move to offering more services under the same company umbrella. The companies continue to emphasize the “one stop” solution to all facets of security required by the discriminating customers of today that have an even more need to protect its property, employees and systems given the worldwide increase in physical as well as cyber-security attacks and threats. Note especially, the move by Allied Universal, Securitas and G4S (the Three Industry Leaders) 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:

Also referred to as:

“Security Guards”

“Manned Guards”

“Security Professionals”

- *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.

Most recent new offerings:




- *Drones*
- *Security Robots*
- *Cyber Security*
- *Canine Security*
- *Systems Integration*

THE THREE LEADERS SHAPING THE DIRECTION OF THE INDUSTRY

There are three companies 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 27% 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 \$24.5 billion U.S. contract security industry, gaining 5% over the 2015 year; these are the ones shaping the future of the industry.

	2016 U.S. Revenue (in billions)	Percentage of Market Share	2015 U.S. Revenue (in billions)	Percentage of Market Share
	\$5.3	22%	\$4.5	20%
	(1) \$4.2	17%	(1) \$3.7	16%
	(1) \$2.4	10%	(1) \$2.2	8%
	\$11.9	49%	\$10.4	44%
Remaining Market	\$12.6	51%	\$12.6	56%
TOTAL MARKET	\$24.5	100%	\$23.0	100%

(1) Includes Canada and Mexico — an insignificant portion of total North American revenues.

THE THREE LEADERS SHAPING THE DIRECTION OF THE INDUSTRY

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

Revenues are up 14% in the North American Market. Eight percent of this growth comes from major acquisitions.

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

Systems Integration and Integrated Guarding Revenues are increasing over 30% per year.

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 of 2016, 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 MacAdreus & 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.

Ownership:

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

Financial Statistics:

- North American revenue \$5.3B (the majority of the revenue comes from the U.S.)
- Synergized proforma earnings \$450M

Source: Information from management and news releases.

* Fractional shares rounded up

Universal Services of America Pre-Merger

At the time the merger was announced in April of 2016, Universal had a run rate 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 3 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

Allied Universal is owned by three private equity groups, along with certain key executives and management. Since it's not publically traded, its annual report to the shareholders are not part of public records.

Steve Jones, the CEO of Allied Universal said this in a recent news release to its employees and customers ...

- We grew another \$600 million in revenue within one year by adding new accounts and acquiring five additional companies, making us the unequivocal leader in guarding services throughout all of North America. Our security professionals and our company play a major role in keeping America, parts of Canada and other service areas safe and secure.
- In North America, we serve over half of the Fortune 500 companies and nearly every major retail mall in the U.S. From healthcare facilities, commercial office buildings, manufacturing and industrial plants, residential communities, transportation facilities, and government services, Allied Universal has a significant security presence.
- Our local teams all across North America managed the integration of 150,000 security professionals, combined locations of both legacy companies, updated the uniforms and rebranded all of the offices and operational material we depend on to perform our jobs and serve our customers daily.
- Our training and development teams did an amazing job integrating the company's training programs to create a world-class AU Institute that contains a library of training material for both field and office employees.
- We've introduced several technological innovations to help improve the security industry in a positive way and offer our clients enhanced solutions for protecting their properties and assets.

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Direction

Allied Universal will continue to focus on organic growth as it rolls out its more aggressive marketing plans and introduces its systems and technology services to existing and new customers. It's goal is to execute a 6% organic growth rate — higher than the industry average.

It will continue its acquisition pace of manned guarding companies — with a new focus — niche companies that provide new geographic, as well as, vertical markets with an immediate accretive effect to its current 8.5% Earnings Before Interest Taxes and Depreciation.

Allied Universal will continue building its present systems and technology capabilities with a view for large acquisition in these areas.

So What's Allied Universal's End Game?

Typically, private equity groups have an investment horizon of 5 – 8 years after the acquisition; then they exit by selling to another private equity group, or in some rare cases, going public. Given the large size of the merged Allied Universal company, finding another private equity group large enough to give the original investors the return they expect and need is challenging. Therefore, it seems the going public option may come into play.

In fact, Steve Jones, mentioned this possibility when interviewed by The Philadelphia Business Journal in September of 2016 – about a month after the merger was finalized:

"It is our goal to build a lasting company that goes forward for generations to come. In order to really do that with private equity partners, eventually we'd have to go public... likely in two years," Jones said.



History

Securitas had its beginnings in Sweden in 1934 when Erik Philip-Sörensen bought a small manned guarding company. The company grew as it acquired several small security companies throughout the southern areas of Sweden.

For the next 40 years, the company would introduce technology to its security services offering and expanded internationally. In 1972, the company was branded as Securitas, with a logo consisting of three red dots representing the company's core values of "Integrity, Vigilance, and Helpfulness". Securitas carries this same logo today.

An interesting little known fact to the Securitas story is that in 1976, Erik Philip-Sörensen sold the Securitas Group to his sons Jörgen Philip-Sörensen and Sven Philip-Sörensen. In 1981, the group was divided between the two sons with the international operations developing into Group 4 (the beginnings of G4S) and the Swedish operations developing the Securitas brand.

The Securitas company would eventually be listed on the Stockholm Stock Exchange; which financed its quest for international expansion including its purchase of Pinkertons in the U.S. in 1999. Thereafter, it bought American Protective Services, First Service, and Burns (then a \$1.5 billion mega security company). These acquisitions, along with a series of smaller purchases, made Securitas the largest security company in the world.

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- **Swedish Public Company** – Nasdaq Stockholm

Financial statistics:

2016 compared to (2015):

- **Global Revenue**
\$10.1B ↑11% (↑7%)
- **North American Revenue**
\$ 4.2B ↑^a14% (↑4%)
- **North American Organic Growth** – 6.0% (4.0%)
- **North American Operating Margin** – 5.9% (5.6%)
- **Earnings Per Share** –
↑9% (adjusted for items affecting comparability and impairment losses), the largest increase in Securitas' history

Source: 2016 Annual Report

^a — Significant percentage coming from the acquisition of the \$330 million Diebold company in February of 2016.



Securitas Today — Around the Globe

Globally, Securitas has revenues of approximately \$10.1B (2016 figures) generated from 53 countries throughout North America, Europe, Latin America, Africa, the Middle East and Asia. Securitas is organized into four business segments:

	% of Global Revenue	Revenue in U.S. \$
Security Services North America	41%	4.2B
Security Services Europe	45%	4.6B
Security Services Ibero — America	12%	1.2B
Other (includes Africa, Middle East, and Asia)	2%	.1B

Securitas' average overall annual growth during the 2007—2016 period was 6% divided equally between organic growth and acquisitions. Growth for security solutions and electronic security in 2015 was 38%; representing 11.5% of the Group's total volume. In 2016, growth was 56% in this category and was 16% of total volume — approximately \$1.6B.

Further into the 2016 Annual Report, Securitas states that its client retention rate for 2016 was 94 percent (91% in 2015). The employee turnover rate was 71% (67% in 2015).



Securitas — North America

Excerpt from Securitas' 2016 annual
Report to its shareholders by
Santiago Galaz, Divisional President,
Security Services North America ...

“Securitas’ specialization in each part of the protective services package is key.

The consolidation of the security industry in North America is creating many opportunities for Securitas. We can offer a complete range of protective services that includes on-site, mobile and remote guarding, electronic security, fire and safety, and corporate risk management. Our specialization in each of these services is key and has made us the leader in the market. Utilizing these services, we can fulfill the security requirements of our customers in the U.S., Canada, and Mexico.

Securitas’ electronic security offerings and expertise has been strengthened following the successful integration of Diebold’s Electronic Security business in North America. We now have national coverage in the U.S. and Canada, a full spectrum of electronic security capabilities, a strong service organization and a focus on long-term customer relationships.

In 2016, organic sales growth continued to develop positively. Good customer retention, strong new sales and increased sales in security solutions and electronic security resulted in growth that outpaced that of the market.

Appropriate training for our employees is a vital part of our strategy. We offer a broad range of training programs, from basic training to highly specialized training for specific customer segments and assignments. Our customer portal gathers all necessary security information for both the customer and our employees and is another important tool that ensure a high level of professionalism.”

In February of 2016, Securitas North America bought Diebold’s \$330 million systems integration business for approximately \$350 million. It is estimated that with this acquisition, Securitas systems integration business in North America is approximately \$500 million — approximately 12% of its total North American revenues.

At \$4.2B in revenue, Securitas has approximately 18% of the U.S. Contract Security market.



Direction

Alf Göransson, President and CEO of Securitas AB, states in the Annual Shareholders' Report that ...

"Securitas is leading the ongoing transformation of the security industry from traditional guarding to a much broader spectrum of protective services. Our progress is based on efficiently integrating technology, people and knowledge — combining on-site, mobile and remote guarding with electronic security solutions, fire and safety, and corporate risk management. Our focus on achieving our long-term financial goals while delivering superior customer value in our daily operations is proving successful. Securitas' results for 2016 demonstrate that we are able to combine the two; earnings per share increased 9 percent compared with 2015. 2016 was our strongest year to date."

"Detecting crime before it happens:

As the transition to Group-wide digital systems continues, Securitas is moving closer to achieving its vision for 2020. Our short and medium-term actions are well underway, with internal projects to address SOC (Securitas Operation Center) consistency and IT infrastructure, as well as strategic acquisitions in electronic security completed during the year. Securitas' focus is now shifting to the next phase of our long-term ambition — predictive security."

"Securing future growth and profitability:

Our strategy drives Securitas' efforts to grow and increase our profitability. Securitas will continue to invest and play a leading role in combining guarding services with electronic security, actively pursuing organic sales growth in security solutions and electronic security. This strategy allows us to grow faster than the security market average and improves our profitability."

Excerpt from Securitas' 8/14/17 Press Release, announcing new President/CEO

"For more than ten years as Securitas' President and CEO, Alf Göransson has successfully developed Securitas. Today, the company is the leading company in the security industry, offering our customers complete security solutions based on both advanced electronic security and more traditional solutions. The transformation in the industry is happening fast and the next step will be to capture on the possibilities from new digital technology. This transformation has to be managed quickly and powerfully to maintain our position. It is very satisfying that Magnus Ahlqvist, President of Securitas' European division, has accepted to take over the role as President and CEO as of March 2018. During his two years in the company, Magnus has showed strong leadership and great insights of the industry's challenges, as well as a genuine sense of finding the best solutions for Securitas' customers. With Magnus as the new President and CEO, we secure continuity in the company and a continued powerful implementation of Securitas' strategy," says Marie Ehrling, Chairman of the Board of Securitas.

Note: Throughout this report on Securitas a factor of .115 was used to convert Swedish Krona (the currently used by Securitas in its reports) to U.S. Dollars.



History

G4S began as a “night watchmen” company in Copenhagen, Denmark in 1901. In its early years, it operated under the name of Falck (Falcon) and transformed itself several times until the year 2000 when it merged with Group 4, a security firm formed in the 1960’s by the Philip-Sørensen family. The merged company was called Group 4 Falck and in 2002 purchased The Wackenhut Corporation; then a \$2.8 billion company founded by George Wackenhut in 1954.

The company was rebranded again to be called G4S when Group 4 Falck merged with the British head-quartered company, Securicor, in 2004. The combined revenues of the 2 companies at the time of the merger was approximately \$5 billion.

G4S Today — Around the Globe

Globally, G4S has statutory revenue of approximately \$9.9B (2016 figures) generated from security services provided in more than 90 countries. G4S reports its global growth against two measurements:

1. Statutory Revenue — represents total revenue, including businesses to be divested or closed. Since 2013, G4S has divested some of the traditional standing security officer business around the world with aggregate revenues of approximately \$1.3B; producing sales proceeds of approximately \$450M. In the 2016 year alone, G4S closed 4 businesses and sold 12 businesses; realizing proceeds of approximately \$105M. In 2016, it reached agreement to sell its G4S Israel business for \$115M, the transaction was closed in 2017, therefore was not in the

2016 figures. Further, G4S plans to sell or exit 27 more businesses (with revenues of approximately \$580M).

2. Continuing Business Revenue — represents statutory revenue adjusted for businesses to be divested or closed. The 2016 global continuing business revenue was approximately \$8.9B — a 6.3% continuing business revenue increase over the 2015 year.

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London and Copenhagen Stock Exchanges

Financial statistics:

2016 compared to (2015):

Global Statutory Revenue

\$9.9B ↑ 10.6% (↑ 4%)

North American Revenue

\$2.4B * ↑^b 12.4% (↑^a 5.8%)

North American Organic Growth — ↑^b 12.4% (↑^a 5.8%)

North American Operating Margin — ↑^b 13.3% (↑ 6.6%)

Underlying Earnings Per Share — ↑ 16.5% (↑ 14%)

Source: 2016 Annual Report

^a — Net of adjustments for businesses divested

^b — Relating primarily to integrated systems business and retail solutions.



G4S Today — Around the Globe
(Continued)

G4S still limits its acquisition activity in the U.S. security market to mostly electronics and high-end investigative type companies. Its manned guarding acquisition activity has been concentrated in the higher margin emerging markets — Africa, Asia Pacific, Latin America, Middle East and India — now representing approximately 40% of G4S's total revenue; which grew by 5.4% for the 2016 year.

Since 2004, G4S has invested heavily to position itself as an integrated security company providing manpower and technology, systems and software. Globally, G4S produced a 36% growth (in 2016) in its technology, software and systems businesses; which now represents 13% of G4S's total revenue from continuing business. Forty-one percent of G4S's technology revenue comes from the North American market.

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G4S Today — In North America

Excerpt from 2016 "Integrated
Report and Accounts"
Reported by: John Kenning,
CEO of North America

"G4S North America is predominantly an integrated Secure Solutions business for commercial customers, with some government contracts including border protection. The Group's innovative cash management solution for retail customers saw significant increased revenue and profit growth in 2016. In North America, our revenues grew by 12.4% and our pipeline indicates the potential for further growth. Cash Solutions revenues grew by a factor of more than 40 helped by Retail Solutions momentum. Revenues from our technology, software and systems businesses grew by 17% excluding retail Cash Solutions. Manned security revenues grew marginally with new customer contracts and growth in existing contracts being offset by lower temporary and short-term work than in 2015 and a reduction in demand in Canada due to the impact of lower oil prices on the economy.

PBITA [Profit before interest, taxes and amortization] increased by 13.3% helped by a favourable sales mix and efficiency gains, partially offset by investing in organizational capacity to manage our rapidly growing integrated systems business and Retail Solutions.

Key contract wins include the renewal of an aviation contract in Canada for a further five years and expansion of the Retail Solutions contract portfolio.

We have a strong contract pipeline with opportunities across diverse sectors including energy, retail, finance, healthcare and data centres."

At \$2.4B in revenues, G4S has approximately 10% of the U.S. Contract Security market.

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Direction














- G4S continues to invest heavily in new services and new markets that are driving its top line, as well as margins.
- It will continue expanding into the “Emerging Markets” presently representing approximately 40% of the Group’s revenues — with a goal of pushing this to 50%.
- In North America, G4S will be enhancing its unified security offering including access control, systems integration, and monitoring (fire, video and intrusion). It will make more visible its newly enhanced RISK360 web-based application that provides incident and case management for its customers.

Note: Throughout this report on G4S, a factor of 1.3 was used to convert Pound Sterling (the currency used by G4S in its annual reports) to U.S. Dollars.

U.S. CONTRACT SECURITY COMPANIES WITH FOREIGN OWNERSHIP

In 2017, two major foreign contract security companies entered the U.S. market through acquisitions—ICTS Europe and Paladin Security. As this White Paper is being published, at least two more multi-billion dollar foreign security conglomerates are searching for the right U.S. flagship company to buy and expand their diverse security offerings in the U.S. After all, the U.S. claims the largest security market in the world, and a growing international company can't claim "bragging rights" without establishing itself in this market.

Below are the foreign security companies with U.S. security company holdings:

U.S. Company	U.S. Revenue (in USD)	Foreign Ownership	World Revenue (in USD)
	5.3B	(1)  WENDEL (2)  Partners Group	N/A
	4.2B		10.1B
	2.4B		9.1B
(3) 	47.7M		255.6M
(4) 	N/A		500M
(5) 	N/A	 Paladin Security	450M

N/A = Not Announced

(1) 33% Ownership

(2) 16% Ownership

(3) Primarily provides sky cap services at airports

(4) ICTS Europe purchased Gate Safe from gategroup (the largest airline catering company in the world) in May 2017

(5) Criterion Security merged with Paladin Security (Canada). The merged company will operate in the U.S. under the name PalAmerican Security.

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 \$24.5 billion with adjustments). Based on recent trends and results of a survey by our office - there will be real growth in the overall market figures - an insignificant amount from companies converting from “in-house” to contract security; with most of the growth coming from the national and regional companies increasing their electronics, systems integration and integrated guarding offerings.

For this report, we are using the \$24.5 billion estimated market size for the U.S. Contract Security Industry to also include 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, in many cases, provide for a lump sum rather than a break out of each service.

Also, in the past, the reporting agencies have put the growth rate for the U.S. contract security market consistently in the 4 – 5% range; but this year the growth was 6.5 %. Approximately 1.5% of this higher than expected increase resulted from the \$330 million Diebold acquisition by Securitas in February of 2016. Additionally, the growth rate within the technology, software and systems offerings for the entire North American market grew at much higher rates than in previous years. G4S reports this growth to be in the 17% range.

Securitas more than doubled its systems integration revenues with the acquisition of Diebold, and Allied Universal continued to grow its systems business in the low double digit figures through more service offerings to its traditional manned guarding customers.

For traditional manned guarding, much of the revenue growth for the Regional and Small companies is coming from price increases

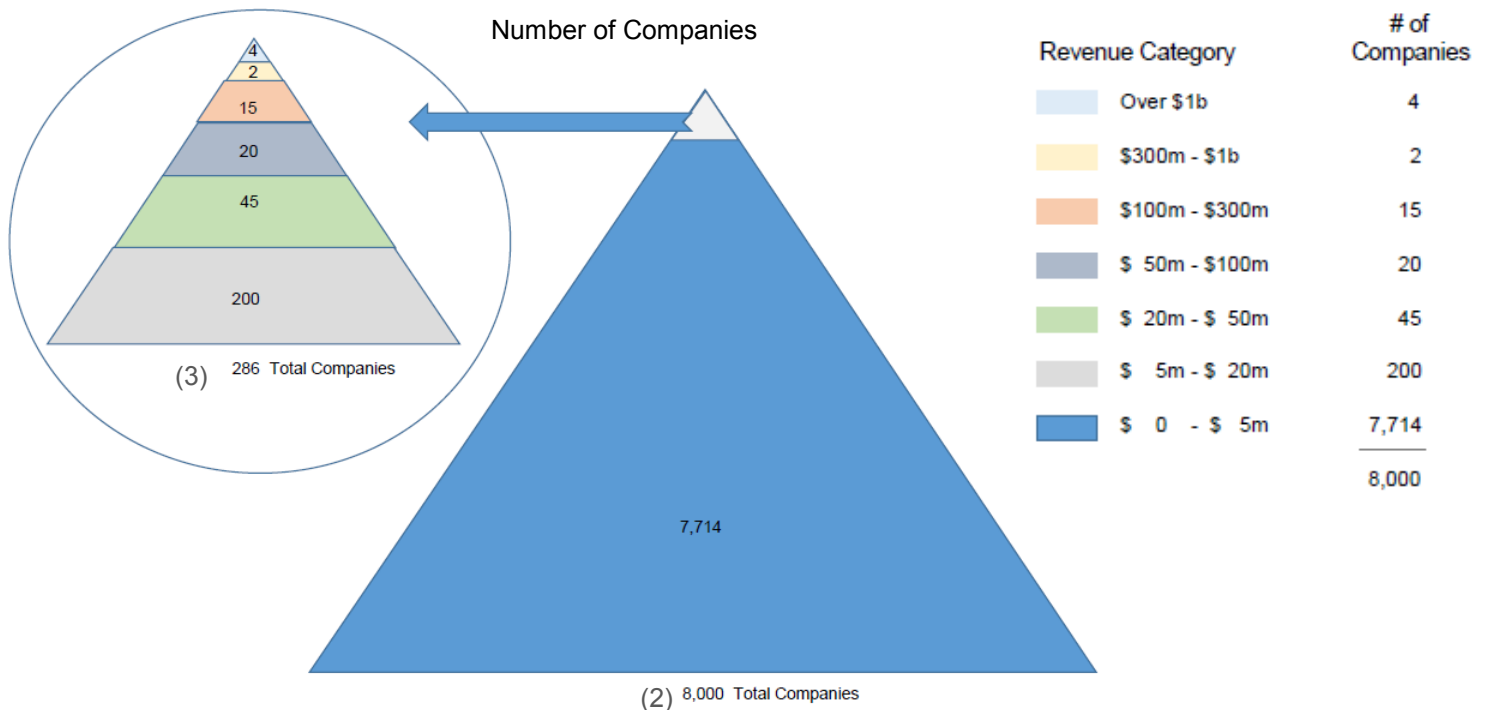
to offset rising wages (due to low unemployment) and mandated ACA costs; with an insignificant amount coming from existing customers increasing billable hours or in-house conversions to contract security.

Source of Revenue Increase

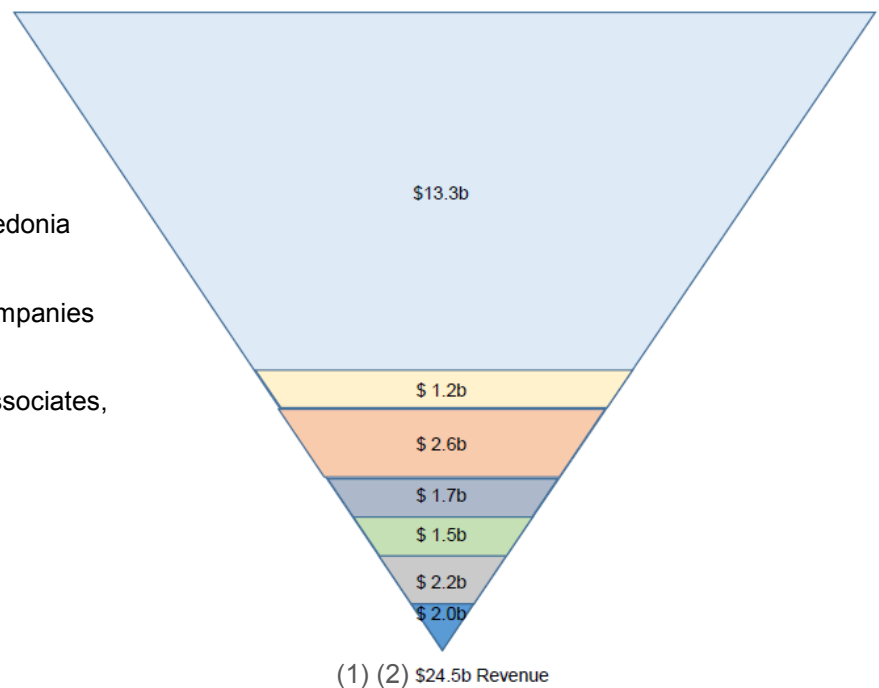
Source	Large Companies	Regional and Small Companies	Total Industry
Electronics/Systems Integration	(1) 2.4%	0.1%	(1) 2.5%
Manned Guarding:			
New Revenue	Minimal	Minimal	Minimal
Cost Pass Throughs	2.0%	2.0%	4.0%
Percent Increase	4.4%	2.1%	6.5%

(1) 1.5% from the acquisition of Diebold by Securitas (\$330 million in revenue)

SIZE OF THE INDUSTRY — REVENUES AND NUMBER OF COMPANIES



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 \$24.5 billion revenue
3. Information from files of Robert H. Perry & Associates, Inc. and the *Security Letter*

EMPLOYEES

TREND: The number of employees in the U.S. Contract Security Industry increased by an insignificant amount for this 2017 report. Although the total revenues were up 6.5%, most of the increase came from the systems integration/integrated guarding sectors (both low labor intensive) - with minimal growth in the number of additional security hours added, or in-house converting to contract security.

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 use 3 sources:

1. 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.- which includes outsourced and in-hours security officers, as well as other positions not normally classified as manned security personnel.
2. A May 2016 Occupational Employment Statistics Report by the Bureau of Labor Statistics report that indicates a total of 1,103,120 contract security officers, but also includes some categories of labor not normally classified as manned security personnel.
3. Files of Robert H. Perry & Associates, Incorporated which computes the total labor force based on a ratio of the number of personnel reported by the large companies in relation to the corresponding revenues of such companies – adjusted for estimated part time officers.

Based on the above, considering that outsourced security personnel represents a little over 50% of the total manned guarding 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 outsourced U.S. Contract Security Industry. This reflects a nominal, if any, increase over the 2016 reporting year even though the total market increased 6.5% in terms of revenue. Most of the revenue growth was in the electronics and integrated guarding sectors, which is not labor intensive.

A July 29, 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

TREND: Average wages for U.S. Contract security officers are increasing due mostly to more aggressive unionization and higher minimum wage mandates.

COMPENSATION

A May 2016 U.S. Bureau of Labor Statistics report 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 EMPLOYEEES

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. The ones that are armed 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.

Continued Next Page

EMPLOYEES

ARMED EMPLOYEES (Continued)

Certain industries prone to increase in violence are experiencing a ramped up demand for armed security officers. A February 12, 2016 article in the “Beckers Hospital Review” said this about the increase in the need for weapons:

“In 2014, 52 percent of hospitals reported their security personnel carried handguns, while 47 percent reported arming them with Tasers, according to a national survey cited by “The New York Times”. Those numbers are more than double the estimates from just three years prior.”

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) predicted 4% growth in the industry through 2017, with lesser growth during the next five years. The three industry leaders have enjoyed an aggregate of 6% organic growth, which means at approximately 5% industry organic growth, the larger companies are winning customers away from their smaller competitors. Also, as indicated on page 22, the growth in the manned guarding market coming from an increase in billable hours to existing customers or bringing on new customers that previously did not have contract security has been minimal. Most of the market growth has been in the traditional manned guarding companies adding electronics, integrated guarding and systems integration components to their service offerings .

GROWTH FACTORS

Below is the source of the “potential” growth for new security in the industry — much of this reporting period’s growth coming in the form of “integrated guarding” from existing customers, with a minimal amount coming from 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 (i.e.; resulting in “real growth” in the industry); 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 cost their employer more 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. Although there were many companies making this move during this reporting period, the amount of new revenue generated was minimal when compared to the \$24.5 billion market.

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THE FACTORS CAUSING GROWTH AND CONTRACTION IN THE INDUSTRY

GROWTH FACTORS (Continued)

Increasing Crime and Terrorism

Immediately after 9/11 there was a large spike in outsourced security, which eventually settled back down. However, over the past couple of years, the U.S. has experienced a higher crime rate in many of the major cities, along with the continuing fear of “soft” terror attacks or another devastating one like the 9/11 massacre.

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, hospitals, 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. 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 in these vertical markets.

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 64 for more details]

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THE FACTORS CAUSING GROWTH AND CONTRACTION IN THE INDUSTRY

GROWTH FACTORS

(Continued)

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.

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. See page 34 for a more detailed discussion on this topic.

CONTRACTION FACTORS

Companies Closing

Certain industries adversely affected by the downturn in the economy a few years ago are just now 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 27.

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THE FACTORS CAUSING GROWTH AND CONTRACTION IN THE INDUSTRY

CONTRACTION FACTORS (Continued)

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 this reporting year, the 6.5% increase in the contract security market was driven primarily by the increase in the systems integration and integrated guarding efforts of these industry leaders. Each promises continuing growth in the electronics sectors; surpassing the growth in traditional manned guarding services.

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, it is obvious that there is a move for companies to replace or at least supplement their security needs by going to companies offering the electronic/integrated guarding component.

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MANNED GUARDING vs. ELECTRONICS

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 and consulting firm specializing in the electronic security industry, indicated the following in his popular Industry Overview Report at the Barnes-Buchanan conference (now in its 22nd year) in Palm Beach in February 2017:

- Total U.S. revenues for the alarm monitoring/service and systems integration companies are now \$55 billion – ↑6%
- Total U.S. installation revenue is now \$28 billion – ↑4%
- Total U.S. alarm monitoring/service revenue is now \$27 billion – ↑7%
- A minimal amount of the increase came from the MSO's (Multiple Service Offerings — the telecoms/cablecoms) which have steadily entered the market over the past five years. The MSO's account for about 5% of the total electronics security market — no change from the last reporting period.

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. Some 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], and to help overcome their often less than stellar reputations for reliable service. This 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.

Continued Next Page

MANNED GUARDING vs. ELECTRONICS

ELECTRONIC SECURITY (Continued)

The “NEW” ADT

As mentioned elsewhere in this White Paper, ADT is now owned by Apollo Global (which with \$200 billion under management, makes it one of the largest private equity groups in the world). Apollo has already started expanding the ADT brand, which will definitely enhance the success of the Initial Public Offering for ADT that some reporting agencies say is planned for 2018.

The “New” ADT has stepped up its effort to get much larger in the systems integration and cyber security space; thus offering a serious threat to the traditional manned guarding companies already offering or starting to offer these services.

A June 28, 2017 ADT article at securitysales.com describes the efforts the managers of ADT are taking to grow the commercial and national accounts division inside the largely residential focused company. The ADT executives plan to take the roughly \$6 million business unit to \$100 million in 3 years — through the executives’ experience in running large commercial and national account divisions for companies acquired in the ADT roll-up. The article went on to say that one of the acquisitions, Protection 1, came with a Cisco certified Network Operations Center (NOC) and a team of software engineers that provide 24/7 remote diagnostics and monitoring services that allowed Protection 1 to expand its commercial platform to include cyber/network security via a managed services offering.

ADT further solidified its plans to get larger in the commercial systems integration sector, when on July 31, 2017 it acquired Oregon based Protec, Inc. — as announced by *Security Systems News*. Don Bresingham, ADT’s chief of staff, said this about the acquisition, “ This acquisition strengthens ADT’s commercial and national accounts business, which continues to grow both organically and through strategic acquisitions. Protec not only bolsters our presence in the Northwest, but also allows us to add additional support and service to new and existing commercial and national account customers throughout the country.”

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MANNED GUARDING vs. ELECTRONICS

ELECTRONIC SECURITY (Continued)

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

As part of our research for this year's White Paper, our firm sent a questionnaire to over 3,000 security company owners in our files to find out what they were doing to expand their service offerings to include an electronics/cyber security component. The responses were evenly split between the companies with no plans to expand the offerings beyond the traditional manned guarding services and the companies that thought they had to expand their services to compete in this "new" marketplace. The ones with no plans to expand their menu of services thought the expanded menu would be too expensive, or were servicing the type of customers that don't have, and will never have, a need for electronic security. However, many voiced the concern that they were already losing valuable customers to the larger companies that offered these services.

The owners that have expanded their service offerings, or plan to expand, are mitigating their concern over losing manned guarding hours or customers altogether. Industry experts and the customers, to a large extent, are recognizing that an effective security program usually involves both electronics and manned guarding — and electronic devices (such as a video camera) to record what happened and who did it and a security officer nearby to defuse the incident.

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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 eight 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 1, 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 an 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 companies, but a drastic negative change for the small company. The Gross Margin and EBITDA for the national and international companies have improved this year due to integrated guarding growing to represent a much larger percentage of the total revenues.

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.

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MARGINS AND PROFITS

On page 41 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 review of the annual reports to shareholders for the public companies (Securitas and G4S), and conversations with key executives of the large privately-held companies; as well as financial reports sent to our office by owners of various small and regional privately-held security firms.

The resulting figures in the chart indicates a decrease in site level profits over the past few years of approximately 4%. There has been 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 that responded to our recent survey 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 decreasing in many metropolitan cities, the wage creep factor has been more prevalent than in other times in the recent past. 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 58 for a detailed presentation].

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MARGINS AND PROFITS

FACTORS INCREASING DIRECT COSTS (Continued)

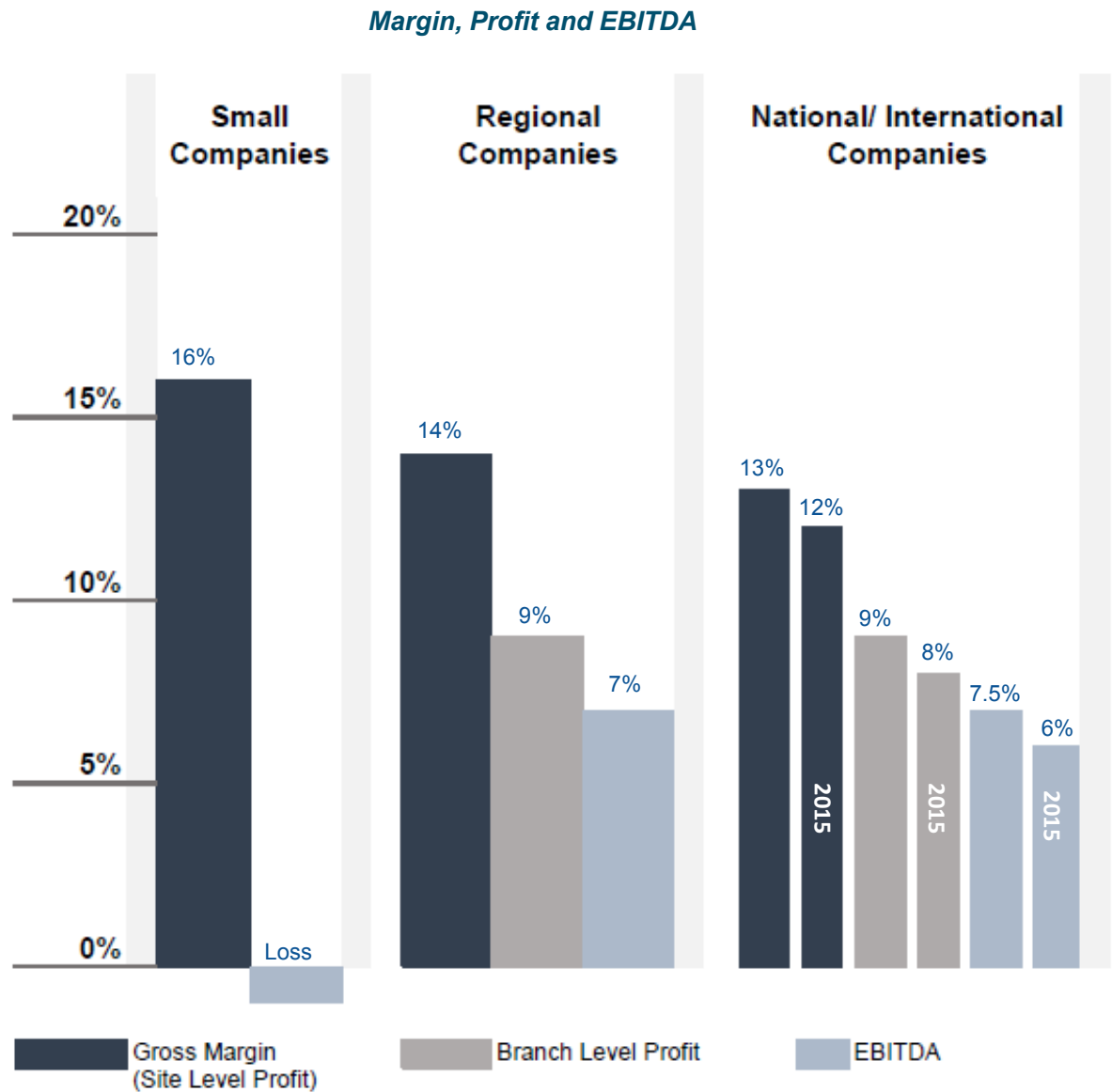
[Increasing Unionization](#) [See page 62 for a detailed presentation]

[Increase in minimum wage](#) [See page 62 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](#) – the company that wants/needs to stay competitive today is having to make a large investment in technology, which is necessary to offer more services to the demanding customers (i.e.; integrated guarding). The initial cost of this investment is high, thus driving down the margins for a period until the additional services can be offered to the customer. 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 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 the EBITDA is decreasing significantly for these smaller companies.

MARGINS AND PROFITS



2015 figures improvement resulting from increased integrated guarding mix (at higher margins) and Allied Universal creating a more efficient footprint post merger.

MARGINS AND PROFITS

MARGINS, PROFIT AND EBITDA MATRIX (Continued)

Gross Margin (site level profit) - the billing to the customer less all costs assigned to the site, such as: compensation for the billable officers, wages for the dedicated non billable supervisors (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 (not assigned to an account) if there are a lot of “cold start” sites, etc.

Branch Level Profit - the profit at site level less all the cost to operate the branch office (for companies with multiple branch offices).

EBITDA - Earnings Before Interest Taxes Depreciation and Amortization.

Small Companies - Revenues less than \$10 million; owner manages the business and has customer relationships. 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.

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.

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. The gross margins are not decreasing, but increasing, due to the move to have more volume in the higher margin security offerings.

MERGERS

MERGER AND ACQUISITION ACTIVITY

TREND: 2016/2017 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, the past four years 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 2016/17 period was anything but moderate in terms of size of transactions and transactions significant to indicating the direction in which the industry is headed. Below is an overview of transactions of particular significance:

- February, 2016 — Apollo Global Management acquired ADT, marking Apollo’s initial entry into the security space.
- August, 2016 — AlliedBarton and Universal Services of America merged to create the largest contract security company in North America
- September 2016 — Apollo Global Management becomes the largest investor in the Constellis Management-Led buyout

MERGER AND ACQUISITION ACTIVITY

FOLLOWING ARE THE ANNOUNCEMENTS FOR THE LARGE COMPANY MERGER AND ACQUISITION ACTIVITY AROUND THE WORLD IN 2016 THROUGH THE 7 MONTHS ENDED AUGUST 1, 2017

Manned Guarding Transactions 2016 through 7 months ended August 1, 2017

U.S. Transactions:

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 (now 150,000), is the largest security services company in North America. ***Allied Universal***, will maintain headquarters in Santa Ana, CA and Conshohocken, PA and is expected to have annual revenues of approximately \$4.5 billion [now \$5.3 billion].

September 2016 – ***Constellis Announces Closing of Management-Led Buyout.*** The buyout is headed by affiliates of certain funds managed by affiliates of Apollo Global Management, LLC to also include members of management of Constellis.

October 2016 – ***Allied Universal acquires FJC Security.*** FJC was headquartered in Floral Park, NY and serviced clients in the government sector; as well as residential complexes and healthcare industries. FJC had revenues of nearly \$300 million.

MERGER AND ACQUISITION ACTIVITY

MANNED GUARDING U.S. TRANSACTIONS (Continued)

March 2017 – Constellis agrees to buy Centerra Group. Constellis (see September 2016 announcement above) agrees to buy Centerra Group for an undisclosed amount of money from an affiliate of Alvarez & Marsal Capital; who bought this Federal Government division of G4S back in 2014 and renamed the company – Centerra.

ALSO:

June 2017 – Constellis announces acquisition of AMK9, based in West Point, Georgia, and a leader in K-9 security services, sales and training around the world.

August 2017 – Constellis has agreed to acquire Omniplex World Services Corp., a Virginia based company that investigates intelligence agencies, the Department of Homeland Security and other federal agencies.

Foreign Manned Guarding Transactions:

May 2017 – Apax Partners completed its sale of Garda World Security. Garda World Security, headquartered in Montreal, Canada, is one of the world's largest privately-owned security and cash services. The buyers were Rhone Capital and Stephan Crétier (Founder, Chairman and Chief Executive Officer).

MERGER AND ACQUISITION ACTIVITY

Electronics Security Transactions 2016 through 7 months ended August 1, 2017

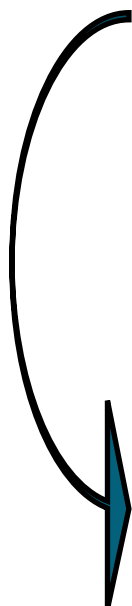
U.S. Transactions:

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](#) ADT will be merged with Protection 1 (acquired by Apollo in 2015). 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.

September 2016 - [Johnson Controls and Tyco complete merger](#) With \$30 billion in revenue and 117,000 employees, this powerful combination brings together best-in-class product, technology and service capabilities across controls, fire, security, HVAC and energy storage, to serve the full spectrum of end markets including large institutions, government, commercial buildings, retail, industrial, small business and residential.

July 2017 - [Apollo may take ADT public at the end of 2018 for \\$15 billion](#), which would be the largest private equity-backed initial public offering since hotel company Hilton Worldwide Holdings, Inc. went public with a \$19.7 billion valuation in 2013 (according to Reuters).



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. There are indications that large PEG's, may now be looking at the Contract Security Industry — evidenced in part, by the announcement on the preceding page regarding Apollo's purchase of Constellis Holdings, LLC, the owner of the U.S. military security services company 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 remained very active in buying smaller, tuck-in companies during this reporting period. It's important to note that the annual revenue from the contract security companies owned by these Private Equity Groups amounts to over \$7 billion (excluding Constellis) and represents approximately 30% of the total U.S. Contract Security Industry.

Company	PE Partner	Date Invested	Overview
		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.
	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 \$90 million.
	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 \$275 million per year.
	 WENDEL  WARBURG PINCUS  Partners Group REALIZING POTENTIAL IN PRIVATE MARKETS	August 2016	All three of the Private Equity Groups are co-investors and own collectively about 87% of Allied Universal - billing around \$5.3 billion per year.
		September 2016	Apollo, the lead investor in the transaction, teamed with certain key executives in this management lead buy-out. It's included in this list of PEG sponsored U.S. companies, since it bought the G4S Government Services business, and other smaller companies with some of its revenues coming from traditional government service locations in the U.S. Constellis has not publically released its total revenue figures.

THE M&A OUTLOOK



























As for the large public international security companies such as Securitas and G4S, there has not been much activity in buying traditional manned guarding companies from these mega companies in 2016 or 2017 to-date, anywhere in the world. They are enjoying continued and sustainable growth in revenue and profit 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.

There is continued growth pressures from the contract security companies partnered with Private Equity Groups. The security companies owned by the PEGs are getting pressure to maintain at least 5% net growth (and some even more aggressive), and they have a readily available funds that can make it happen. There is presently several billion dollars in “dry powder” set aside by the active PEGs for acquisitions and more robust marketing efforts for organic growth. Except for a couple of large (\$50 — \$100 million in revenue) transaction presently in process, these companies have quit buying just to get more volume; rather they’ve become very selective. They are redirecting their acquisition efforts to companies that take them into new vertical and/or geographical markets — companies that don’t require a lot of “fixing” in order to transition.

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	EBITDA
2010			\$140M	N/A	\$34.5M	25%	N/A
2011	Security Consultants Group		\$106M	N/A	\$22M	21%	N/A
			\$765M	N/A	N/A	N/A	N/A
2012	(1) 		\$350M	N/A	N/A	N/A	N/A
2013	(2) 		\$130M	N/A	\$24M	18%	N/A
2014			\$500M	N/A	\$130M	26%	N/A
2015			\$130M	N/A	N/A	N/A	N/A
			\$2.2B	\$150M	\$1.67B	80%	11.67x
			\$500M	N/A	N/A	N/A	N/A
			\$400M	N/A	\$131M	33%	N/A
2016	(1) 						
		 	\$4.5B	\$440M	N/A	N/A	N/A
			N/A	N/A	N/A	N/A	N/A

N/A = Not announced

See Foot Notes on Next Page

OVERVIEW OF LARGE CONTRACT SECURITY COMPANY TRANSACTIONS

FOOTNOTES TO
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(Continued)

- 1) These transactions were announced as a merger. The EBITDA figure for Allied Universal (\$440m) was estimated based on proforma synergies.
- 2) 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

TREND: The selling multiples for large security companies acquired over the past few years have been at an all-time high, as evidenced by the almost 12 times earning paid for AlliedBarton (by Wendel) and the unannounced, but suspected, high multiple paid for Guardsmark by Universal before it merged with AlliedBarton. With the decreased number of attractive large company targets that remain, the large buyers will be redirecting their growth efforts toward new vertical and geographic markets; and a more robust marketing effort.

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 placed on the large and small contract security companies.

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?

As mentioned on page 21 of this White Paper report, at least two very large foreign companies, providing mostly manned guarding services in various other parts of the world, are presently evaluating the U.S. market and looking for a flagship company to buy; then will grow that company through tuck-in acquisitions. This may be the next wave of acquisition activity in the manned guarding industry in the U.S. and a way for the owners of the smaller manned guarding companies to make their exits.

As for the three industry leaders, the acquisition activity of manned guarding companies will decrease dramatically. Instead, the acquisition activity will be in the systems integration and integrated guarding sectors. In fact, Securitas and G4S have been on the sidelines for acquisitions of manned guarding companies in the U.S. for the past 5 years and don't intend to ramp up acquisition activities in this sector any time in the near future. These industry leaders will invest their money in more aggressive organic growth efforts in an effort to maintain their average 4% - 5% annual growth.

SELLING PRICES FOR SMALL CONTRACT SECURITY COMPANIES

TREND: The selling multiples will level off or decrease as the pro-active acquirers complete their national footprints and have to pay a higher interest rate for monies borrowed to make the acquisitions. Any new buyers coming in the market will not come in at multiples higher than is what is now being paid.

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.

The multiples the buyers have been 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 were 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) were paying less to borrow money and were 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.

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. Also, in the past, many of the active acquirers were needing to make acquisitions in order to get into new geographical markets. The traditional active acquirers have now developed an attractive national footprint. They are in all the major markets and can service national accounts with very little, if any, need to subcontract the business to a smaller company, or acquire a company just to get into the market. They will still make smaller acquisitions, but the selling company now has to be strategic to the buyer’s growth criteria and has to meet more stringent due diligence criteria.

FACTORS DRIVING OWNERS TO SELL IN TODAY'S MARKET

TREND: The results of a recent survey conducted by our firm indicated continuing higher operating costs suppressing gross margins. The medium size and large companies are able to adapt by getting more efficient, thereby reducing overhead costs below the gross margin line. Smaller companies do not have the organizational structure or money to invest in technology to reduce overhead cost, thus exploring the possibility of selling to their larger competitors.

Below are some of the factors driving the owners to sell in today's market:

- **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 for Owners of Contract Security Companies” on page 62 for a detailed discussion on the increase in minimum wage.
- **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 (3 years later) is still very much uncertain; which is driving some owners to put their company on the market now.
- **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 all but the largest companies. 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.

FACTORS DRIVING OWNERS TO SELL IN TODAY'S MARKET

- **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 6%, while the total market grew at an unimpressive 5%. 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.
- **Unionization** – [See page 62 under "Challenges 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 out-source security was getting started in a big way. These owners are now reaching retirement age and are looking to sell their business.

Continued Next Page

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

- **Decline in alternative investment opportunities** — Before Certificates of Deposit and bond rates dropped dramatically, 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 it. However, now that these safe haven investment returns are so low, the profits the owners are making from their company cannot be replaced by returns on the after tax monies invested from the sale of the business.
- **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.
- **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.
- **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.

OUTLOOK

CHALLENGES FOR OWNERS OF CONTRACT SECURITY COMPANIES

TREND: Most of the “Challenges” mention in our previous White Paper remain today; and some are even more critical.

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 2017 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. Although, as this White Paper goes to press, Congress is trying to repeal or greatly amend the current ACA; no progress has been made in this effort.

Increase in Minimum Wage

Several states have announced a “proposed” or already “approved” increase in a December 30, 2016 *Wall Street Journal* article that indicated that there are now 19 states that have implemented a raise 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 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.

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.

CHALLENGES FOR OWNERS OF CONTRACT SECURITY COMPANIES

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.

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.

Potential Challenges

There are several new pieces of legislation in the local, state and Federal areas being discussed; which if enacted will have a dramatic negative effect on manned guarding companies. In fact, some have already passed and are being implemented on the local and state levels. Most notably for the labor intensive manned guarding industry are:

- Predictive Scheduling — penalties for not informing a security of a change in his/her schedule within a certain number of days or hours in advance of the required report to post.
- 20-Minute Break Rule — presently in California.
- 3-Day Sick Pay Rule — presently in California.

OPPORTUNITIES FOR OWNERS OF CONTRACT SECURITY COMPANIES

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 years 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.

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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ROBERT H. PERRY
& Associates, Incorporated

P.O. Box 67 (zip 27402)

301 N. Elm Street, Suite 710

Greensboro, NC 27401 (U.S.A.)

Tel: 336.272.2266 ♦ Fax: 336.272.1142

rhpa@roberthperry.com ♦ www.roberthperry.com

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