CONTRACT SECURITY INDUSTRY

2023 REVIEW – 2024 OUTLOOK

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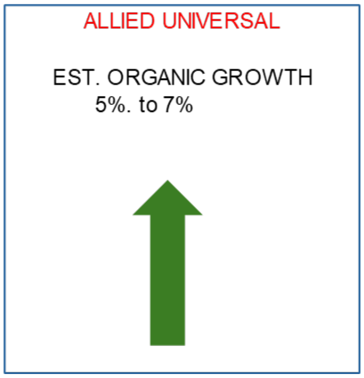
As we begin the 2024 New Year, many of the negative events of 2023 remain and are likely to continue since we've done nothing to fix them. There are still mass shootings in our schools, malls, and public venues; racially and politically motivated demonstrations, and riots; cybercrime; artificial intelligence being used for harmful purposes; "smash and grab" thugs costing our retailers billions of dollars – and ultimately being paid for by the consumer; and the upsurge in illegal immigrants crossing our borders. There are also more countries involved in wars, and the threat of a resurgence of COVID and other viruses that virtually shut our country down for over 18 months. On the economic front, we are still experiencing unacceptable inflation rates, causing higher interest costs for companies needing to borrow money.

Despite these events that tend to cripple the general population of companies, the contract security industry remains, as in the past, relatively unaffected, as underscored by our interview with the owners of many of the privately held professionally run companies. In fact, most reported low double-digit growth for 2023 and are expecting more of the same for 2024 by continuing long overdue billing rate increases to customers and expanding the technology offerings that enhance the traditional standing security officer services, albeit at much better margins.

We also looked at the published information for the Big 4 security companies, with global revenues exceeding USD $1 billion. Following the trend of their smaller competitors, the revenues and profits were up dramatically, a significant amount also coming from billing rate increases and an expansion of their technology offerings.

The next two pages delineate the growth for the Big 4 Security leaders:

Allied Universal, a privately held company, does not publish its financials in the public domain. Therefore, we went to news releases to find out what they were reporting about Allied, its present and future. Below are excerpts from select publications:



S&P Global – December 21, 2022:

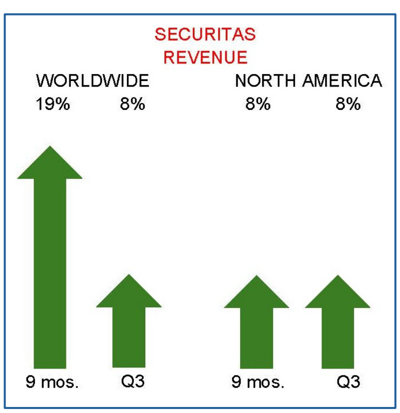
- The improvements mostly in non-billable overtime premium expected in 2023, should push EBITDA margin of around 7.3% in 2022 to 7.7% in 2023
- Revenue growth is expected to be 5% for 2023 and 4% for 2024

Moody's – June 15, 2023:

- Allied Universal's EBITDA margins are expected to remain in the 8.5% - 9% range.

Orange County Journal – January 15, 2024, from an interview with global CEO, Steve Jones:

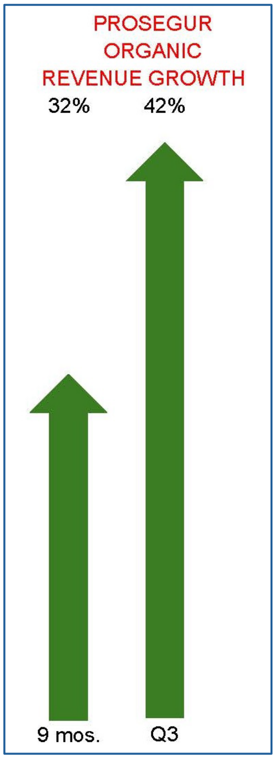
- Allied presently enjoys sales of around $20.5 billion and is looking at an initial public offering in 2025 or 2026 when the sales are expected to reach $25 billion.
- Allied's technology division now generates about 8% of its total sales.
- Allied expects organic growth to continue in the mid-single digits and supplemented by larger strategic acquisitions especially in the technology security sector.



From 09.30.23 Interim Report

- Worldwide annualized revenue approximately $15B
- North America annualized revenue approximately $6B
- Worldwide revenue growth: 9 mos 19%
- North America revenue growth: 9 mos 8%
- Worldwide revenue growth: Q3 8%
- North America revenue growth: Q3 8%
- Worldwide organic growth: 9 mos. 10%
- North America organic growth: 9 mos. 7%
- Worldwide organic growth: Q3 8%
- Worldwide technology revenues: 32% of total sales
- North America technology revenues: 36% of total sales

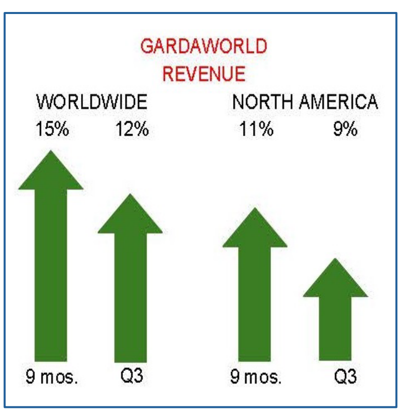
PROSEGUR



From 09.30.23 Interim Report

- Worldwide annualized sales: approximately $4.5B
- North America annualized sales: approximately $600M
- Worldwide revenue growth: 9 mos. 7% (after considering 32% organic growth and -27% effect from converting foreign to local currency).
- Worldwide revenue growth: Q3 2.3% (after considering 42% organic growth and -40% effect from converting foreign to local currency).
- North America revenue growth: Prosegur does not break out the North America revenues, but it's estimated that the revenues are approximately $600M annualized with 25% organic revenue growth for the 9 mos.

GARDAWORLD



From 10.31.23 Interim Report (9 mos.)

- Worldwide annualized revenue: $4.5B
- Canadian annualized revenue: $1.3B
- U.S. annualized revenue: $2.6B
- Worldwide revenue growth: 9 mos. 15% (primarily organic)
- Canadia revenue growth: 9 mos. 9% (primarily organic)
- U.S. revenue growth: 9 mos. 12% (primarily organic)
- Worldwide revenue growth: Q3 12% (primarily organic)
- Canadian revenue growth: Q3 9% (primarily organic)
- U.S. revenue growth: Q3 9% (primarily organic)

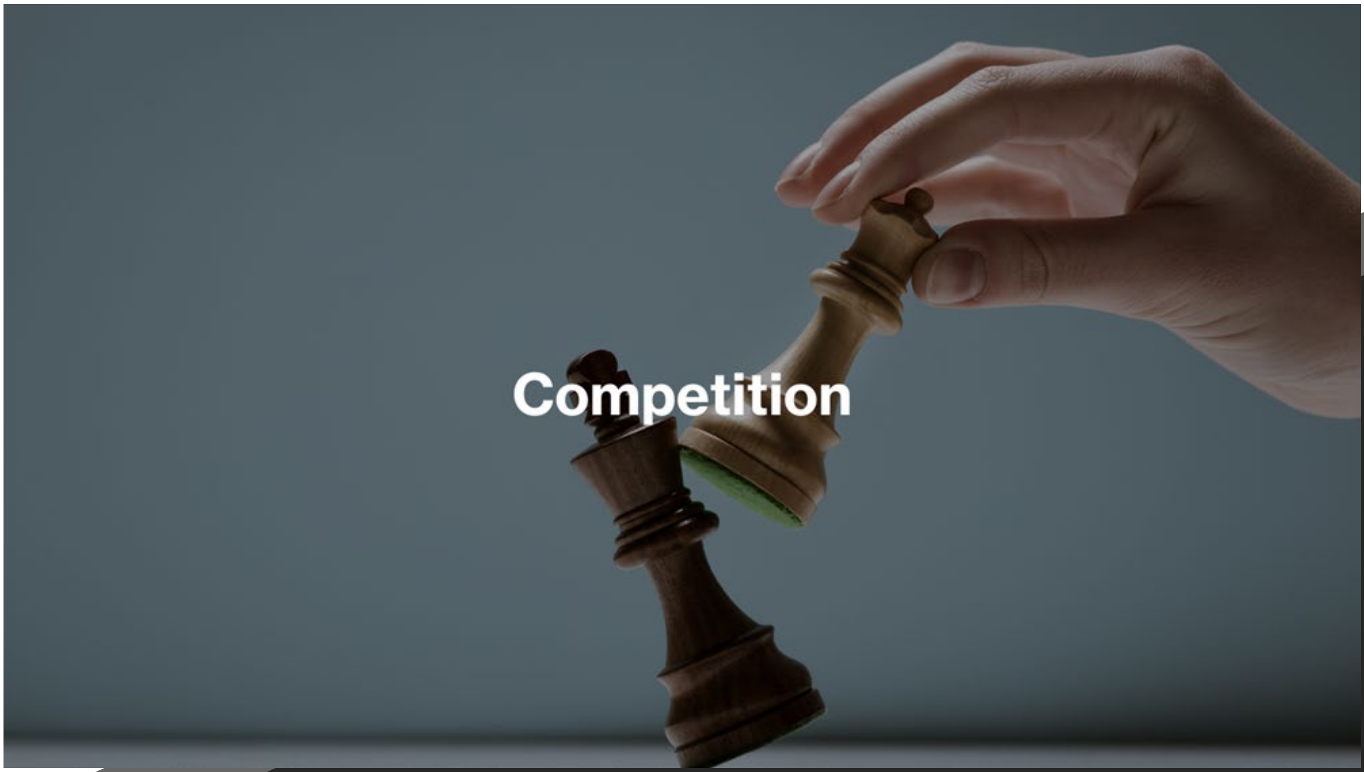
MERGERS & ACQUISITIONS

There were no acquisitions of pure-play manned guarding companies during 2023 for sellers with revenues over $100 million. There were 21 acquisitions of smaller companies, most not announced publicly. Allied Universal, the most active in acquisitions for the past several years, slowed its pace of acquisitions from about 10 – 12 annually to five in 2023. Although it studied 50 – 60 purchase candidates during 2023, most did not fit Allied's strategic growth plans. Allied is expecting the pace to pick up during the 2024 year as the interest for acquisition funds gets less expensive.

However, there was one significant divestment in the industry – a large, primarily manned guarding company, sold its systems integration business:

In July 2023, the Paladin Group of Companies, founded in 1976 in Vancouver, British Columbia, announced the planned sale of its Paladin Technologies business to Bosch Building Technologies. The transaction closed in September.   Paladin Tech went on an acquisition spree in 2021 creating a significant systems integration company providing access control, intrusion detection, monitoring, and audiovisual solutions with 1,500 employees, and revenues approaching $400 million generated from 18 offices across Canada and 17 in the U.S. While the parties agreed not to announce the purchase price and terms, based on the selling price to revenue ratio of similar system integration company transactions, it's estimated that the price was in the $500 million to $600 million range (approximately 125% - 150% of revenue).   This acquisition brings an unusual twist to how the manned guarding companies plan to grow. The transaction takes the Paladin Group away from being an owner of a technology company – that offers systems integration to enhance its manned guarding services – the direction most companies are going in today. Paladin will now subcontract its systems integration business to Bosch, who picked up Paladin's line employees and management. The Paladin Group will use the proceeds from the sale to pay down expensive debt accumulated while it was on its systems integration acquisition spree, leaving a large war chest for organic and acquisitive growth in its manned guarding and parking services offerings.

Subsequent to the Paladin Technologies acquisition, Bosch announced its plans to divest its security products business making it a "pure Play" system integrator employing over 7,000 people in eight countries.



STRONGER COMPETITION

In addition to the Bosch/Paladin transaction, the year 2023 saw other strong companies enter the systems integration market as competitors to Securitas, Allied Universal, and other “primarily” manned guarding companies that offer systems integration services . . .

With approximately $7 billion in revenue, **ADT** recently developed EvoGuard through its ADT Commercial company (ADTC). EvoGuard is a new suite of intelligent autonomous guarding solutions and services aimed at helping to cost-effectively enhance corporate security programs while responding to high turnover rates and ongoing labor shortages in the guarding market. When this technology was developed, ADT was 20% owned by State Farm Insurance, having $42.5 billion in annual premiums. In August, ADT announced the sale of ADTC to prior ADT executives and GTCR (a large Chicago-based private equity firm) for $1.6 billion. GTCR manages over $25 billion in equity capital and has committed to additional investments in ADTC to implement a strategy to drive continued growth and innovation. Prior to this sale, ADTC was already competing with the manned guarding companies that offered systems integration services and will now be competing in the manned guarding segment with heavy financial backing from GTCR. In November, it was announced that ADTC would be rebranded as Everon.

Johnson Controls, with approximately $30 billion in revenue, announced the integration of its present C-Cure 9000 access controls and event management system with Cobalt Robotics’ remote guard service. In announcing the move, JC said this about the new service: “As companies turn to technology to secure their facilities and keep employees safe, the integrated Johnson Controls and Cobalt solution can automate responses to major security incidents from breaches and break-ins to risks like open doors. With businesses struggling to find security guards and keep costs under control, this integrated system is the way to automate alarm response at a substantially reduced cost.”

“For many of our customers, hiring expensive security guards during a difficult labor shortage is not an option,” said Rick Focke, Director of Product Management, Enterprise Access Control, Johnson Controls. “With this integration, companies can get an all-in-one security solution from alarms to robots to keep their building secure and employees safe. The security workflow between our alarms and Cobalt’s robots is seamless, and all reports are automatically created and tracked so companies can make facility improvements over time. Dispatching AI robots from state-of-the-art security alarms is going to be the future of securing buildings in a much smarter, more cost-efficient way.”

THE HEADWINDS FACING OWNERS GOING INTO THE 2024 YEAR

The Headwinds detailed in our 15th Edition White Paper remain:

- The proposed rule banning non-competitive agreements introduced by the FTC on January 05, 2023, is now expected to be ruled on in April 2024.
- The shortage of labor continues. Although non billable overtime premium pay increased dramatically from its pre COVID level, many owners are reporting an improvement going into the 2024 year.
- State unemployment taxes are starting to rise because of the state funds being depleted by payouts during the pandemic.

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The possible biggest headwind facing owners of all companies may come from the need to increase taxes to pay for the increasing budget deficits brought about by the massive federal funding during the COVID-19 pandemic – which amounted to around $1.6 trillion. All economists agree that the federal debt, now almost $35 trillion and growing, must be considered as Congress reaches yet another round of negotiations to approve the new budget – which for now is just being kicked down the road through on-going extensions.

And many are supporting tax increases to curb further deficit growth. President Trump signed off on the Tax Cuts and Jobs Act (TCJA) in 2017 which was supposed to raise income to the federal government. However, the Congressional Budget Office is saying the law is going to add another $1.8 trillion to the debt over the next ten years. For this reason, some, if not all, of the TCJA tax cuts will be allowed to expire late in 2025. The rates will go back to their previous levels or increase.

Below are the most popular increases being considered, to include the expiration of some of the TCJA cuts:

- Restoring the Corporate Income Tax from its present top rate of 21% back to 35% - although many are suggesting it be increased to just 28%, either way a significant increase.
- Taxing gains on the sale of capital assets at ordinary income rates. The present capital gain tax rate is 20% (with another 3.8% for investment income). Some are proposing the capital gains rate be capped at 30%. The increase, if enacted, would mean a lot less the owner puts in his/her pocket from selling their company or any other capital asset qualifying for capital gains tax treatment.
- Eliminating section 199A 20% business deduction. This section allows non-corporate taxpayers to deduct up to 20% of qualified business income (QBI). It has proven to be a large tax break for shareholders of pass-through entities such as S Corporations and LLC’s.
- Expanding the base for computing employment taxes – to include pass-through income. This change would keep shareholders of such companies from escaping or reducing self-employment tax by drawing small salaries (subject to FICA tax) replaced by large profit distributions (not subject to the tax).

So as companies become more profitable from the billing rate increases, the expansion of the technology offerings and the ramped-up need for security the question becomes: how much will the “headwinds” listed above reduce the enhanced profits resulting in less take home pay for the owner?

NEW AND CONTINUING OPPORTUNITIES FOR CONTRACT SECURITY COMPANIES IN THE 2024 NEW YEAR

The growth trend for the large, midsize and smaller security companies, along with the increased demand for better security has prompted a flurry of calls to our office from Private Equity Groups looking at making investments in the security space.

The "Tailwinds" detailed in our 15th Edition White Paper on the industry continues for the 2024 year:

- Shrinking Public Police Forces, as well as increased crime, are putting a high demand on Contract Security Services
- Customers understand the labor challenge and are giving less resistance to billing rate increases.
- Advanced technology is becoming less expensive, making it easier for the smaller companies to compete.
- New and expanding markets – "off-duty policemen" and "K-9 offerings", as well as school security and closed neighborhoods.

The most recent compelling evidence supporting the increase in the need for security came on September 11, 2023, when Allied Universal released its commissioned 75-page publication "World Security Report 2023".

The headline of the publication reads: "More than USD $1 trillion in revenue was lost by companies as a consequence of physical security incidents in 2022 . . . one in four publicly listed companies reported a drop in their value following a security incident over the last year." The very detailed report is a result of interviewing nearly 1,800 chief security officers from large, global companies in 30 countries representing a combined annual revenue of more than USD $20 trillion in 2022.

What is clear from this report is that companies around the world are looking for better technology to protect their people and investments – technology that is not only expensive but requires extensive training and re-training to implement and maintain. The large primarily manned guarding companies are ahead of the curve on developing this technology, therefore will be the vendor of choice to provide these services to many of these companies.

The report went on to say – as it pertains to North America:

- 59% of the companies plan to invest significantly more in physical security in the next year (which is well about the global average). This is driven by rising operational costs at 56%, domestic security concerns and duty of care to employees, both at 53% - all significantly above the world view.
- Companies intend to implement more effective security as the main impact of all threats, with 39% making this choice in North America, well above the global average of 32%.
- North America is the third most advanced region in the use of cutting-edge and emerging technology at 40% of those surveyed. Latin America and Asia Pacific had a higher concentration of companies using this level of innovation. However, North America also has the second highest percentage of companies using only basic or minimal technology at 36%, suggesting that there is a big gap between the most and least advanced.
- Companies in North America will also invest in robotics, drones, and autonomous vehicles at a rate well above the global average. The biggest barrier to using more technology cited by 45% of companies was cost of maintenance and lack of skills in the security workforce at 42%, both above the average. Hiring the right people is more challenging in North America than anywhere else, with 71% saying it is extremely or very challenging to recruit.

SOURCES:

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IPVM – 01.09.24

SDM – 11.15.23

ADT News – 08.08.23

PR Newswire – 10.02.23

Security Business Magazine – 08.08.23

The Tax Adviser – 12.01.23

Council on Foreign Relations – 12.04.23

PBS News – 01.02.24

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