

UPDATE COVID-19 and its Effect on Buying/Selling Contract Security Companies



COVID-19

*It's too early to tell what effect the pandemic will eventually have on our overall economy, but with the rapid rise in unemployment (almost 20% as of the writing of this report and climbing) and an obvious decline in GDP, we're already meeting the economists definition of a recession with credible predictions it will get much worse in the coming weeks. In an effort to find out what may have changed since our report of two weeks ago, we continue to talk with executives of contract security companies. The responses we're receiving, **for the most part**, underscore the fact that most security companies are still faring well in these trying times since the demand and need for security isn't necessarily affected by the performance of the economy as a whole. However, there are some security companies experiencing decreases in revenue (depending on the type of customers they are servicing) and some of the decreases are dramatic.*

G4S

G4S, the largest security company in the world, by **employee count**, and too large to qualify for any U.S. stimulus monies, showed almost 5% revenue growth for the 2019 year compared to 2018. It announced on March 23 that, in spite of its current very strong financial performance and substantial liquid resources, it's considering not paying the final 2019 dividend due to the uncertainty of COVID-19 and its impact on certain key markets since March 11th.

Securitas

As mentioned in our previous COVID-19 report - **Securitas**, the largest security company in the world by **revenue count** and also too large to qualify for any U.S. stimulus monies, announced a 5% organic growth in 2019 over the 2018 year. However, it expected 1.5 to 2.5 percentage points decline in organic growth for the Q1 2020 report to shareholders based on COVID-19 estimated impact to the March results.

Note: Allied Universal and Garda are not publicly traded entities, thus have not made any press releases regarding the effects of COVID-19 on their companies. Prosegur, the Madrid headquartered public company and one of the contract security world leaders, also has not made any public announcements regarding the effect of the virus.

The Report from the Smaller Companies

Most of the executives I talked with indicated that the COVID-19 crisis, so far, has had only a minimal effect on their revenues. They are adding additional services for current customers and even picking up new customers needing help during this crisis. Also, many said their largest challenge is not in replacing lost revenue. Their largest challenge is filling vacated posts caused by the ramped up unemployment benefits and enhanced family leave stimulus payments that encourages the security officers to not show up for work. This trend leads to a larger percentage of hours paid at non billable overtime premium rates. Some also mentioned that they were concerned that their banks would put a squeeze on their credit lines when the time came to renew the loans; since banks will be ever more cautious in renewing or giving additional loans when they pull out of the financial crisis.

The companies that are still holding their own don't know how long the crisis may last, so they are trying to preserve or raise additional cash to take care of this unknown. To do this, most of the companies, that qualified, applied early for the Payroll Protection Plan stimulus money; and most of these are still waiting to receive the funds. Some of the executives I talked with said they were not applying for the loan since they were not sure their company would meet the complicated qualifications to have the loan forgiven,

and didn't want to add additional debt.

[As a side note: there have been many technical corrections, clarifications, and additions to the original 880- page Cares Act pronouncement published on March 27, 2020. Some of the changes have made the Act more attractive by qualifying larger companies while other changes put more strings attached to eventually getting the loan forgiven; which is a very important condition to those receiving the monies. Companies applying for the loan should be consulting with an expert on the Act; one that's up-to-date on all the changes and technical corrections that have been issued since the release over two weeks ago. The American Institute of Certified Public Accountants is working very closely with the writers of the Act to advise in correcting and/or clarifying many of its provisions; thus a CPA should be a good source of up-to-date information].

Buying and Selling Contract Security Companies During the COVID-19 Crisis

It's still very much a seller's market. The pre-COVID-19 active buyers are looking for quality acquisition candidates that have the types of accounts they need to replace the revenue the buyers lost, or will lose, during the pandemic. These pro- active buyers are promising an expedited closing. For the smaller acquisitions, they are using an abbreviated purchase contract and a short form due diligence list.

From our perspective, we haven't slowed down during this economic crisis. However, our travel (as well as the executives for the buyers and sellers) has been suspended for attending face to face meetings. We're handling the on-going negotiations through video conferencing and using our secure Virtual Data Rooms to provide due diligence information. We're putting the finishing touches on the Confidential Information Memorandum (the book that tells all the good things about our seller/client) for the sellers that started gathering their information before the pandemic became a concern and will be managing the sale of these companies soon.

Some owners are concerned about the future of their companies and asking themselves – do I have the financial reserves to get through the pandemic, especially if it lasts for several months? Will the market for selling companies remain in the seller's favor, or will the market turn into a "buyers will buy, but only if the seller is willing to take a deep discount" type of transaction? Will my customers need extended terms to pay their bills, thereby requiring more bank financing to stay afloat? How much will the unemployment benefits received by the employees I have to lay off affect my experience rating, thus an increase in the amount of unemployment taxes I will be paying in future years?

These owners that are seriously thinking about how they will weather this economic storm are also looking at several viable options:

1. Selling the entire company while the market is still seller favorable
2. Selling just part of the company:
 - Certain types of customers (customers that demand a premium price in today's market)
 - Selling branch offices - the "less is more" concept. Typically a company operating through several, fully staffed branch offices, will have under-performing offices even in good economic times. The crisis is exacerbating this problem where the decrease in revenue makes it even more difficult to justify the fixed costs of keeping the offices open. Even before COVID-19 raised its ugly head, our firm helped many companies in divesting select office locations that were under-performing. The sellers found that they were more profitable on less volume by selling off certain branches in areas where they were not efficient.

Although the buyers are still paying attractive multiples, they are paying close attention to the stability of the revenue streams and asking questions:

- Are the customers the type that are stable during a pandemic or do they decrease their coverage?
- Is the seller's sudden increase in revenue a result of extra coverage during the pandemic, which will probably go away when the crisis is over?

Also, the buyers are offering the sellers a hedge against selling when revenues may be temporarily depressed due to COVID-19. If the seller's revenue is depressed at the time of the sale, the buyers are providing for an increase in the purchase price as the customers come back with their pre-COVID-19 revenue levels.

We send our sincere thanks to all the more than 800,000 contract security officers that are on the front lines of fighting this devastating virus. We hope they eventually get the recognition they deserve.

Please know that we are ready to help in any way we can. If you need to talk about anything in this article, please don't hesitate to reach out. Since all the members of our firm are working from their respective homes during this shut down period; you can reach me faster if you call my mobile phone at 01.336.339.4849.

Please stay safe, my friend. We will pull out of this, although our way of life as we knew it before the pandemic will have changed - in many ways.

Robert H. Perry

For over 25 years we have successfully completed over 250 sell-side engagements for security companies located in 8 countries and having revenues between \$2M - \$200M.

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