

DIVESTITURES *of* SECURITY GUARD COMPANIES

A periodic informational letter published by Robert H. Perry & Associates, Incorporated
Dedicated to Buyers and Sellers of Security Guard Companies

FREQUENTLY ASKED QUESTIONS

There have been dramatic changes in the marketplace for buying and selling security guard companies over the past couple of years. This issue of *Divestitures* is devoted to the questions frequently asked by owners considering the sale of their companies in this new environment. Most of the questions pertain to the U.S. market, although we manage sale transactions in other countries as well.

I *Is now a good time to sell my security guard company, or should I wait?*

The current market for the sale of security guard companies in the U.S. is very different from any of the times we've experienced in the 25 years we've been managing sale transactions in the industry .

Unlike times in the past, the aggressive buyers in the market today are not buying companies just to add volume. They're looking for companies that share their criteria related to the value of the company (see questions #3 and #4 below). This means many owners wishing to sell in today's market will unfortunately find that their companies are not saleable at all, or if so, at a greatly reduced price.

Whether or not an owner should consider selling in today's environment depends on how prepared the company is to meet these higher standards set by the aggressive buyers.

But the good news is that high quality companies operating in desirable locations and prepared to pass the buyer's stringent due diligence are commanding unprecedented high prices in today's market.

As for the future, obviously no one knows what the values will be two or three years from now, or even six months. I don't think the values will get any higher unless the industry is able to greatly improve margins; and competitive pressures will probably not allow this to happen. And I think buyers will get even more critical in evaluating purchase candidates because of the increasing importance placed on hiring standards, risk tolerance and geographic preferences.

Since many of the changes that will need to be made in order to maximize the company's selling price may take several months or years, we're advising owners to start making the changes now.

2 *How can I determine if my company is saleable and what can I do to make it more attractive?*

Based on the changes that have taken place in the market for selling security guard companies over the last couple of years, we've learned the increasing importance of planning for the sale. As mentioned above, buyers are no longer just buying volume to boost sales. They're looking for companies with compatible operations and accounts that can be easily integrated into their existing business. If buyers can integrate these companies with minimal disruption or adjustments, they will realize a greater return on their investment sooner rather than later. This means that they no longer buy companies expecting to make changes after they buy it. The buyers now want the changes made before the sale. This shift in the buyers' criteria delayed or in many cases terminated the

prospects of many recent would-be sellers whose companies did not meet these new stringent standards.

Improving the saleability of security guard companies is the reason we started our **Strategic Planning Engagement**. We work with owners wishing to sell in the next 12 to 36 months or more. This engagement is geared to identify the changes needed to make companies meet the more stringent standards of buyers, and thereby enhance their value for the future sale.

Another reason we have decided to get involved earlier in the anticipated sale process is that our firm benefits most when we can make our client-companies more valuable. Since most of our revenue comes in the form of contingent fees (based on a percentage of the eventual selling price), the more value we can add to the company the more our firm benefits in an eventual sale. In effect, the sellers and our firm come out winners.

In a typical strategic planning assignment, we will come to the company's office (or off-site) to examine and evaluate several aspects of the business that are important to the eventual selling price of the company. We'll concentrate on five areas:

- Guard account characteristics
- Personnel
- Financial reporting
- Risk management
- Operations

3 *How is the selling price determined?*

In spite of what you might have heard on the street that the valuation of guard companies is based on multiples of gross monthly revenue or percentages of annual revenue, this just isn't true.

Unfortunately there's no longer a one-size-fits-all formula for determining the likely selling price of a security guard company. There are many differences and variables when comparing companies. Variables such as these determine the buyer's level of interest and ultimately the selling price:

- The owner's operating territory
- The company's operating and account characteristics
- The size of the company

Value is also affected by the buyer who may be the most aggressive in the market when the owner is ready to sell.

There are two types of buyers for security guard companies— investment groups and synergistic buyers (i.e., other security guard companies). Both types of buyers go through a detailed profit model computation to determine expected profits from the company after the acquisition, and then apply their models to determine their return on investment and offering price.

Each buyer uses a very different approach in determining an offering price. **Investment groups** are looking for large flagship companies with \$50 million in revenue or more. They may pay as much as 8 times the SELLER'S EBITDA (earnings before interest, tax, depreciation and amortization), *not* the buyer's. Usually these groups pay only 5-6 times EBITDA for non-strategic acquisitions.

The **synergistic buyer**, on the other hand, prepares the profit model based on what the BUYER will make after considering the synergistic savings they will bring to the consolidation, such as elimination of back-office costs, savings on worker's compensation rates, and elimination of salary for the seller (who usually leaves after the sale). Surprisingly, the synergistic buyer's offer is usually much better than the investment group's even if the investment group is using a larger multiple on earnings.

When we value a security guard company in anticipation of the sale, we consider both computations. Synergistic buyers do not share the details of their model with us or the seller; it's all part of trying to gain leverage in the negotiations. However, based on our experience in managing the sale of security guard companies, we can anticipate their maximum price if we know certain characteristics of the selling company, regardless of the profit or loss the company shows. We consider about 25 characteristics including:

- Gross account margins

- Type of accounts
- Average account site size
- Account retention history
- Number of armed personnel
- Account contract indemnification language

These are also characteristics covered in our strategic planning assignments.

The gross margin on the accounts has always been an important factor in the valuation process. However, in today's market the margin amount alone is not enough. Buyers today want attractive margins *after* considering a respectable wage rate to the guards.

Because the price is ultimately based on these characteristics rather than the actual profit of the seller, the prices we've received for many of our clients have been 10 to 50 (or more) times our clients' reported profits. In other words, it's really meaningless to express the expected price based on what the seller is showing on its financial statements.

Once we know the characteristics of the accounts and certain other things about the company, we can tell our client what to expect in a sale. The price may be 2 times monthly revenue, 6 times (or greater), or somewhere in between, as determined by the unique characteristics of the company. This large spread in multiples of gross monthly revenue demonstrates why these "street" multiples should not be used.

4 *How does the sales trend over the last few years affect the value of my company?*

The company's growth record has become more important in the valuation process. Although the buyer is basically purchasing the accounts in place at closing and the personnel to run the accounts, the buyers are looking to the growth trend as important evidence of the abilities of the managers going to work for the buyers. This is why an owner should seriously consider selling when

the revenues level off or the growth slows down. It's an indication that the owner has reached a "glass ceiling" and the company starts losing value.

5 *Does your firm tell the owner what to expect in the way of price and terms before accepting the engagement to manage the sale?*

Yes. In fact, we insist on an agreement in principle regarding expected price and terms before we accept the assignment. We've managed the sale of a lot of security guard companies and know what to expect in a sale. If the owner's expectations are too high, we advise the owner to wait until the real value of the company catches up with the price the owner requires. If the owner tries to sell the company with unrealistic expectations, the company will not be sold, and the company's value diminishes for a future sale because the buyers lose confidence in owners who have a habit of putting the company up for sale and then withdrawing it from the market.

6 *How long does it usually take your firm to sell a security guard company?*

Since we specialize in managing the sale of security guard companies, we already know who the most aggressive buyers are, so we don't have to advertise or search for the best buyer. We've also qualified the buyer prospects. This takes SEVERAL months off the time it normally takes to sell the company.

Once we reach an agreement with the owner to manage the sale process, we then prepare the confidential selling memorandum. This takes about two weeks. The negotiations with the buyer leading to a letter of intent, due diligence process and contract preparations take 60 – 75 days. If any of this falls around a major holiday or vacation season, the process may be delayed somewhat.

The entire process starting from the time we are engaged by the owners to manage the sale to the date of closing the transaction takes three to five months.

7 *If I want to sell my company, why retain your firm to manage the sale? Why not negotiate directly with buyers, or through a local business broker?*

Sellers who negotiate on their own or through business brokers generally do so because they think they are saving money. But the money they believe they are saving is more than offset by the lower selling price they receive, not to mention the fees some of the advisors are charging regardless of whether the transaction closes.

All we do is manage the sale of security guard firms, so with our expertise we can add a lot more value to the transaction than the fees we charge our clients. We have recently expanded our services to security systems integration companies, but our specialized experience is with security guard companies.

We are able to add value in several ways:

- We don't have to advertise the company as being for sale. We already know the most aggressive buyers, and we know about their financial ability to handle the deal. Going straight to the best-qualified buyers keeps the buyer population to a minimum, which protects the all-important confidentiality of the sale.
- We know how to present the company. Our unique presentation format shows the most attractive aspects and, usually, the details a buyer needs to know to make an offer. At the same time, we do not reveal specific account information. Our presentation methods enable us to get through the offer stage quickly, which leaves the owner free to run the company and preserve its value during the sale process.
- We manage the remainder of the process. We work with our client's accountants and attorneys toward closing the

transaction. Although we don't offer legal or tax advice, we are often able to assist the advisors when problems arise in these areas. We have managed the sale of over 130 transactions and have the benefit of providing solutions to the many issues that threatened the success of all of these deals—issues that may actually come up in our next deal. We bring the solutions orchestrated by the advisor team on our prior engagements to every seller we represent.

- I think the buyer prospects are more generous and move more quickly when they know we are managing the transaction. They know our reputation in the marketplace and our familiarity with all the buyer prospects. Since we are managing the process, they know that their competitors are probably also looking at the possibility of buying our client's company. This creates a spirit of competition among the buyer prospects, and prompts them to give their best price and terms at the outset. This reduces the normal time for protracted costly negotiations.

8 *Your only office is located on the East Coast of the U.S. How can you effectively represent sellers who may be hundreds or thousands of miles away, or in other countries?*

We spend a lot of time on airplanes. Because our office is located close to a major airport, we can leave our office and be in almost any major East Coast city in about an hour and a half. We can be on the West Coast in less than five hours. With the short connecting time through major airports, we can be in South America or Europe in about a day.

While we're traveling, we have other professionals who stay in our office and handle the administrative functions, prepare our clients' presentation books, use our many resources to locate buyer prospects, and keep up with our traveling schedule.

When we're on the road, we correspond with the office through e-mail, receive

documents at the hotels through overnight packages and fax messages. We track our activities through our custom-made software package, and we have a worldwide website so buyers and sellers can learn more about us. We have a large financial commitment to our resources, but it's all necessary to stay organized and efficient.

Since the largest security market in the world is in the U.S., obviously most of our clients were headquartered here. However, we have represented sellers located in several countries in Europe, South America, and the Middle East.

Our first step in deciding whether to take on a representation assignment is to qualify the seller. We look at the quality of the business and determine the seller's commitment factor. When we feel that the business is saleable and the owner is serious about selling, we start buying airplane tickets and making hotel reservations.

9 *I want to set up a joint venture arrangement with an international security company with the resources to service other worldwide locations for a very important client and then take an executive position with the joint venture partner. Can your firm handle this assignment? If so, how would you handle the representation since we're located half the way around the world from your single headquarters office? (From a recent caller in Israel.)*

We probably can help. Since some international clients are located so far away, it's not practical to have our usual get-acquainted meeting first. Rather, our first step will be to contact the executives we know at the international security companies to find out if there's general interest in the proposal. If there is, we'll accept the assignment. Then we'll prepare the confi-

dential selling memorandum from information a client sends us through e-mail. We will negotiate with the various prospects through phone calls and e-mails until we receive an acceptable offer. Then we'll set up the negotiation meetings probably in a mutually convenient location somewhere in Europe. We'll then manage the process to a successful closing.

[Note – We did in fact locate several interested prospects and accepted this engagement. We managed a series of meetings in Paris and were able to put the joint venture in place for our Israeli client].

10 What size companies does your firm represent?

Since our fee is based on the selling price of the company, and we pay out of our pocket all the travel expenses for the several meetings it takes to manage a sale to closing, the size of the company we can

accept obviously depends on how much travel time and money it takes to attend the meetings, which is determined by the company's location.

We can accept a full management engagement for companies with revenue as small as \$1 million for many East Coast locations. For West Coast companies, our minimum size is around \$3 million in annual revenue, but we frequently make exceptions.

We've managed sale transactions for companies as large as \$75 million, and we've represented multi-billion dollar conglomerates in divesting their security guard company divisions.

You can also view this presentation of *Frequently Asked Questions* through our website at www.roberthperry.com.

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We initiate and manage transactions for sellers of security guard companies. Established in 1977, we have successfully represented over 130 sellers located in the United States, Canada, Western Europe, South America, and the Caribbean.

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