DIVESTITURES
OF SECURITY GUARD COMPANIES

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

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WHY ACQUISITIONS ARE IMPORTANT
... in the life of a successful company

All the reasons for making acquisitions can be summed up in one sentence - **Companies make acquisitions in order to increase stockholder values.** That is why shareholders get excited when they see the company they own a piece of make acquisitions.

And, the *Wall Street Journal* said it best. The headlines in the May 24, 1995 issue read......" In a twist, Acquisition Announcements Are Lifting Shares of Buying Companies."

The article went on to say that investors are driving up the stock prices as they seek out companies with managers who are making acquisitions an integral part of their plan to build and strengthen the underlying assets.

Even though the article addresses just the mega deals on Wall Street, making acquisitions is not an activity limited to these conglomerates. Smaller public companies are doing it....closely held companies are doing it....and even individuals are doing it.

In making acquisitions, the acquirer is sending a signal to the shareholders that a commitment is being made to enhance growth and profits - both of which makes for a sound investment no matter what the form of ownership.

There is though, a difference in the attitude toward acquisitions when we compare service companies to manufacturing and distributing companies. The risks are different, which results in different pricing methods and structuring techniques.

This difference is magnified when we limit the service company category to security guard companies. Security guard companies have their own unique characteristics - both positive and negative.

Because of the negatives, there are fewer buyers for security guard companies than there are for some other types. However, the buyer population is still large enough to render attractive prices to sellers. This became evident when we represented our first security guard company owner.

Prior to selling this company back in 1982, we would have thought that security guard companies had little or no value. The accounts can go away in 30 days. There are very few assets to support a buyer's investment. From a risk standpoint, security guard companies are high on the list.

As we went through the search process to identify buyer prospects, we found that there were companies interested in our security guard company client. However, all the buyer prospects were other security guard companies.

Because of the appeal these buyer prospects saw in making strategic acquisitions, we were able to get our seller a very attractive price. In fact, the prices are even better today, because there are more security guard companies interested in making acquisitions.

So why is this activity in buying

security guard companies so intense today? Are they bought and sold for the same reasons that drive the mega deals on Wall Street?

Now 13 years and over 75 security guard company sales later, we think we know some of the reasons - both right and wrong:

To Accelerate Growth (in volume and profits)

As mentioned above, public and private companies make acquisitions to accelerate sales and profits, which in turn increases shareholder approval.

They have found that growth comes faster if it is done with a combination of marketing and acquisitions.

A type of buyer which we have not yet mentioned, who achieves amazing results from their intense acquisition activity, are the investment groups.

These money managers are in control of hundreds of millions of dollars owned by wealthy individuals, insurance companies or pension plans. Their duty is to invest their funds in a variety of businesses; the goal being a maximum return on the funds at a risk as low as possible.

To satisfy the requirement for a maximum return, they are using the funds to buy companies, and because they have a lot of money to invest, they have to buy a number of companies quickly; otherwise they have funds sitting in a CD or bond account earning a meager four or five percent interest. When they buy companies, their returns are a respectable 20 to 30 percent.

Some of these funds are being used to buy security guard companies. For the initial acquisition, the investment group usually co-invests with seasoned security guard managers. They furnish the funds that enables the company to grow quickly by making a series of acquisitions.

In a short while, they build a major security guard company while continuing to grow through acquisitions and internal sales. Then, when the size of the company and the market conditions dictate, they sell part of the company to the public through a public stock offering. Some of the funds from the stock offering are returned to the original investors and some are kept in the company to finance future growth.

To Gain Additional Volume in Existing Markets

We get several calls each week from security guard companies who need to strengthen their business in certain geographical areas. Most of these buyers call us on a regular basis to give us their "shopping list" of areas in which they must make acquisitions.

The conversations have a common theme. They have an office or several offices that don't have enough volume to justify the overhead. This deficit in volume is usually a situation where the company just couldn't sell enough business to reach the optimum size or they just lost a major account. Whatever the reason for the deficit, they perceive their best course of action is to make an acquisition in the area.

To Enter a New Market Area

There are two reasons for a security guard company to enter a new market. The company may be asked by an existing account to service an additional location or an area may be identified in a long range plan as a target market. In either case, before entering that new market, the company should have a plan for obtaining a sufficient volume to justify the overhead required.

Statistics for the security guard industry supports the notion that the most efficient security guard office should be handling at least 10,000 billable hours per week.

If this is true, a security guard company loses a considerable amount of money every time it expands into a new market. They start with no sales unless they can obtain one or two very large accounts quickly or purchase a company large enough to cover the office expenses while they are building the hours.

Just how much money is lost depends on how fast the company can build the are or find a compatible company to buy.

If the company has average margins, at best there is 20 percent of billings left to cover the office overhead. And if the minimum staffed office costs $150,000 per year, then the office has to have a volume of at least $750,000 just to break even.

If a company is purchased with a volume of at least $750,000 per year, with accounts consistent with the standards of the acquirer, the office will be breaking even from day one; instead of loosing money. If we assume the accounts will be purchased for $200,000, then the acquisition pays for itself in a little more than two years. Which is about 40 percent return on invested dollars - before taxes.

To Gain Expertise in Niche Areas

Sometimes it's difficult for a security guard company to service certain accounts unless they already have a track record within that industry. And they can't get a track record, if they can't get started.Just to gain a track record or an expertise in a certain industry is often a reason for making an acquisition.

Over the years, we have seen acquisitions made for the sole purpose of expanding an existing niche or creating a new one. This has been especially true for accounts like hospitals, gated communities, nuclear plants and shopping malls.

We've even seen companies make acquisitions just to create the perception that they specialize in certain work. A few years ago we represented a small guard company who handled the police duties for a local municipality.

The buyer we chose for this company was very interested in the police work because they could mention it in their annual report to the shareholders which the company knew would be perceived as a very positive move. When they described the police work in their annual report, it sounded like a large division; even though the billings were less than $200,000 per year. It still did wonders for their stock values and the company never did expand this small division.

To Utilize Excess Capital

Rare is the security guard company that has the luxury of excess capital. But the ones fortunate enough to have it, have the additional burden of deciding where to invest it. Investments offered by banks are not the answer because the returns are too low.

The prudent managers use the funds for aggressive marketing campaigns or for making strategic acquisitions .... or a combination of both.

Thus far, in this presentation we have dealt with the right reasons for making acquisitions. Again, the common theme is that acquisitions made for the right reasons increases shareholder values.

The Due Diligence

Sometime during negotiations, the buyer will mention the phrase "due diligence." It can be handled verbally or written in a formal document. In either case, it means that the deal is conditioned upon the buyer verifying certain things about the seller.

Unfortunately, the term does not have a precise definition and often when mentioned, the seller is thinking one thing, while the buyer is thinking another. Because of this, somewhere in the negotiations, a problem may arise.

To most buyers, due diligence is the process of checking the financial records, employee files, and customer files. However, it has a broader application for some buyers and is extended to include visits with employees, customers and banks. For obvious reasons, this broader application is not recommended in the sale of security guard companies because of the need to keep the transaction confidential until after closing.

Sellers should proceed with caution when dealing with the buyer's request to perform due diligence. This does not mean that the request should be denied, or that some things should be withheld.

Rather it means that the seller should request, early in the process, a list of the due diligence items. This way, there's no surprises and both are in agreement with what will be examined or done during the process. This issue is very important and sometimes complicated. We will discuss it in detail in a future informational letter.

HOWEVER, SOME COMPANIES ARE MAKING ACQUISITIONS FOR THE WRONG REASONS

Acquisitions made for the wrong reasons have a diluting effect on shareholder values. Here are some of the wrong reasons:

- For the sole purpose of increasing gross sales without regard to profits
- To satisfy an ego
- Just because other companies are doing it
- Just because a company is available
- When the acquirer has to take an undue risk to finance the acquisition
- For the sole purpose of utilizing excess management talents
- When the two corporate standards are not compatible.

WHO ARE THE BUYERS FOR SECURITY GUARD COMPANIES TODAY?

A good way to identify the type buyers in today's market is to describe our last four transactions:

- ***We represented a seller headquartered in Maryland***

  The buyer was a U. S. subsidiary of a world wide conglomerate; with total sales exceeding 1.5 billion (U.S. dollars). The buyer has guard accounts primarily in the Northeast and mid-Atlantic states. They made this acquisition in order to strengthen their market share in the Maryland area.

- ***We represented a seller headquartered in Alabama***

  The buyer was a large regional privately-held security guard company. They made this acquisition in order to enter a new market; which was contiguous to the markets in which they presently operated.

- ***We represented a seller headquartered in Florida***

  The buyer was a privately held national security guard company owned, in part, by an investment group who controls sever hundred million dollars in invested funds. They made this acquisition in order to gain a niche in gated community accounts.

- ***We represented a seller headquartered in Northern California***

  The buyer was a national U.S. publicly help security guard company, with operations in several foreign countries. They made this acquisition in order to strengthen their market share in the northern California market.

This periodic informational letter is published by ROBERT H. PERRY & ASSOCIATES, Inc.

Established in 1977, we are the recognized specialists in the sales and valuation techniques for security guard companies. We have successfully represented over 75 sellers of security guard companies located in the U. S. A., Canada, western Europe and the Caribbean.

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