Notebook of Ideas for Divestitures of Private Security Companies

Robert H. Perry & Associates, Incorporated

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The 7 Habits of Highly Successful Sellers of Contract Security Companies

Almost everyone has heard at least one story about how some contract security company owner who, not looking to sell the company, was contacted by a generous buyer with an offer the owner couldn't refuse; and after a short period of negotiating, sold the company for some amazing price.

In the real world of selling contract security companies this rarely happens, especially in today's marketplace. While there are some very good opportunities available to sellers

We initiate and manage transactions for sellers of contract security companies.

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today, the "amazing" deals just don't come about by chance. Sellers today have to MAKE the "amazing" deals happen. They have to be more proactive in managing their expectations; a process of getting emotionally ready to sell, preparing the company for the sale and keeping one's perspective.

Here are seven habits we find common in sellers that sell their company at the right time and command premium prices:

1. Successful Sellers will start selling their company the first day they go into business.

The goal of every business owner is to have a business they enjoy running - one that's profitable and one that will sell for a lot of money when the time comes to hand the business over to a buyer and retire.

Unfortunately, many owners are headed down the wrong track in building the company for the eventual sale. According to many statistics, there are around 8,000 contract security companies in the U.S. We estimate that at least 90% are not salable or if so, at a greatly discounted multiple. The owners of these companies have not been building the company with the eventual sale in mind.

We've been managing the sale of contract security companies for over 30 years and nothing much has changed in what buyers are looking for in an acquisition target. The aggressive buyers will not buy accounts that do not meet their predetermined requirements - i.e.; accounts they would not bid on should the potential customer request a proposal. This usually means they're only interested in certain account types, gross margins within a certain range, minimum gross revenues, certain geographical territories, etc.

Successful sellers find out what the buyers are looking for in an acquisition target early in the building of the business; then stay tuned to what's going on in the acquisition marketplace as a way to keep up with any subtle changes in the buyers' criteria.

2. Successful Sellers know what to expect before talking with buyers - who may also be their competitors.

Some owners today have to sell - the business is in financial trouble or the owner has some personal crisis that's calling for a sale - regardless of whether or not the owner is ready.

Then there are other owners that don't have to sell, but would sell if the selling price meets the owner's "target selling price". This is the figure the owner has to have in order to justify selling; it's what is needed to finance that next business venture, or a comfortable retirement life style.

But how does the owner know when the value of the company has reached its "target selling price"? Selling multiples change often and sometimes drastically. The owner could put the company up for sale to see what some of the aggressive buyers will offer, but runs the risk of the sale leaking out to the employees and customers, only to discover that the selling value of the company is not even close to the "target selling price".

The successful seller will have the company valued by a professional experienced in valuations of contract security companies. The small and medium-sized security companies are not valued on multiples of pre-tax profit, as evidenced by the fact that we've received a premium selling price for some of our client/sellers that were losing money. The small and medium-sized companies are valued on attractiveness of characteristics such as; types of accounts, operating territory, operating margins, growth history, etc. The experienced valuation professional knows how to assign values to these and other key characteristics in advising the owner on the probable selling price, down payment and holdback for account guarantees - which is done without the customers, employees and competitors discovering the company may be for sale.

3. Successful Sellers have their "financial house" in order.

A prudent seller knows that the ultimate goal of the buyer is to make more money from acquiring the seller's company than the buyer could make by putting the idle or borrowed funds to work in some other investment. But the owner must be able to prove what the company can make under the ownership of the buyer. This means, for a contract security company, the company should have records that give detailed information on the profitability for each customer (hours billed per week, payroll, billing and other direct costs), detailed accrual basis year-end financials (preferably issued under reviewed reports by outside accountants), as well as current interim financials, non-billable overtime history, workers compensation rates, accounts receivable turnover statistics, etc.

There are several software programs on the market today that are designed to produce these very important reports, and a prudent seller should have them in place to build the financial history required by the buyer during the due diligence. Also, aside from being a great tool in adding value to an eventual sale, these programs enable the owner to run the company more efficiently, thus more profitably, during the time leading up to the eventual sale.

If the seller has poor records, the buyer may still buy the company, but the buyer will have to offer less money to hedge against the uncertainty of the financial records - information either not available or possibly inaccurate.

4. Successful Sellers, over time, becomes less important to the continuity of the business.

We've encountered many sellers over the years that thought it was important for the buyer to think that they were vital to the continuity of the business. During the negotiations, the sellers emphasized over and over how close they were to their customers and how they gave personal service, which was not provided by their multi-national competitors whose decision-making authority was in some headquarters building thousands of miles and several time zones away. These ego boosting comments by the owner left the buyer wondering if they would be able to keep the "spoiled" customers happy after the sale - especially if the owner's primary reason for selling is to retire and leave the business.

Successful sellers will head off these concerns of the buyer by slowly and methodically giving the key managers more account contact responsibility; then easing further into the background and relinquishing some of the detailed day-to-day responsibilities to the managers. When the company is being sold, the buyers will feel more confident that they can keep the customers happy by making sure they hire the managers with the strong customer relationships.

Successful sellers will also make sure the managers are under an assignable non-compete or non-solicitation agreement in case some of the managers decide they do not want to go to work for the buyer, and instead start their own company or go to work for a competitor.

5. Successful Sellers retain experienced advisors .

The Attorney - the attorney will have experience in the legal documents dealing with the sale of contact security companies. The attorney will understand the intricacies unique to handling the language dealing with account retention, operation of the business post-closing, and the representations and warranties necessary to protecting the seller/client in a security company sale transaction. The successful seller will seek out such an advisor even if it means abandoning the legal talent the seller may use for general corporate matters, litigation or estate planning assignments.

The Tax Advisor - although the gross sale price is important in the transaction, the amount the seller has left after paying all of the expenses and taxes associated with the sale is the real measure of the deal's ultimate success or failure. Successful sellers retain tax advisors that are well-versed in the tax ramifications of selling companies, especially the unique challenges that go along with security companies - where the tax allocation of the purchase price is so important to the seller's tax outcome. Also of significant consequence to the seller is selling through a "C" corporation vs. an "S" corporation and possible built-in gains tax; a difficult section of the Internal Revenue Code that requires specialized knowledge in taxes involving the sale of companies.

The Transaction Manager (investment banker, broker or intermediary) - the transaction manager (TM) is usually the professional that gets the ball rolling for the sale. The TM, who will specialize in the contract security industry, will advise the seller on the price and terms to expect in the sale, and identify the most aggressive buyers. The TM will know how to manage the sale in order to minimize the chances of the word leaking out to the customers, employees and competitors. The TM will work closely with the attorneys and tax advisors and keep the momentum moving through the sale process toward an expeditious closing of the transaction.

6. Successful Sellers plan for life after the sale.

We have found that the overwhelming reason owners do not reach a successful sale is because they do not have a plan for what they will do after the sale.

They may, reluctantly, be pushed into talking with a buyer prospect by outsiders (over-zealous business brokers, friends or relatives). The more they talk about it, the better the possibility of selling sounds. Then they're presented with a very enticing offer - a premium multiple by industry standards - and probably the best they will see for many years to come and could possibly be better than any offer they might receive when the time comes that the company has to be sold. Then realism (or anxiety) sets in and they start to think about what they will do when the buyer takes over the company.

They don't want to work for the buyer because of the constraints imposed by the large corporate culture. They feel that they would not make a "good employee". They have devoted their whole life to building the business and didn't have time to develop a hobby - what are they going to do after the sale? Usually these owners terminate the negotiations - the fear of being left with nothing to do or admitting mortality is greater than the financial rewards received in selling the business. The sad part is that these owners usually sell for a lot less in the end, depriving themselves, their family and heirs of the support they need in their "golden years".

Prudent sellers will have planned for life after the sale. They will not let the "what will I do after the sale" concern stand in the way of their getting a premium on the sale. Even if they haven't planned for life after the sale, they know that the premium price can buy a lot of fun hobbies and still have enough money left over to provide for a comfortable retirement.

7. Successful Sellers don't sell at the "top of the market".

Most of us have heard the ol' saying the investors use in describing their success in the stock market: "the secret to success is selling too soon". At first this advice appears counter intuitive - everyone knows that the best price can be reached by selling at the top of the market. However, the stock market changes every nano-second. Investors who wait until the stock market has reached its absolute highest point to order a sale, have waited too late because the market is heading down again.

While the multiple for selling contract security companies isn't quite as volatile, it still changes often and sometimes dramatically. Owners waiting for a buyer to give them "just a little higher price" will more than likely wind-up selling for less than what they would have if they had taken the offer they turned down in the beginning of the sale process - when the multiples were on the way up.

Prudent security company owners understand the current volatility in the market. The multiples have been steadily climbing for the past couple of years; almost to the point the buyers are not getting the return on investment they need. In fact, some of the international companies have slowed their acquisition plans down because the prices have gone beyond the point of prudent buying decisions.

Therefore, these prudent owners will sell when the value of their company reaches the "target selling price" (see #2 above) regardless of whether or not they think there's another multiple or two to squeeze out of the buyers. Some will sell, even if they haven't quite reached the "target selling price", if they feel the market has reached its highest point and has nowhere to go but down.

And there's a number 8 to add to the list of the 7 habits:

8. Successful Sellers don't look back after the sale.

Successful sellers don't spend time second guessing themselves on whether or not they got enough for their business; in spite of their "friends" telling them they would have paid them more. They sold for the right reasons and sold to the right buyer (although many sellers did not entirely agree with the changes the buyer made to the business after the sale). They accomplished their goal - whether it be retirement, getting rid of a financial obligation or just providing for more leisure time.

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