"White Paper" on the US Security Guard Market

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Size of the US Security Guard Market

Revenue:

The latest Freedonia Group study #2362 (in October of 2008) indicates that the US Contract Security Guard market was $22.150 Billion in 2007 and was expected to grow to $28.9 Billion by 2012 – a 5.5% annual growth rate. This same report puts the worldwide security guard market in 2008 as $38 Billion, which means the US market alone is over half the size of the world market. However, a previous report by Freedonia showed the same US market as $17 Billion in 2007 – the difference being a new definition of what is included in the SIC code for security guard companies to include an expanded population of private investigators and other related security groups.

Most industry experts still talk about the size of the "real" security guard market as $17B - $18B; therefore, we'll use $18 Billion for this "white paper" report.

Number of Companies:

Many sources indicate that there are around 10,000 individual security guard companies in the United States alone, with one report indicating 14,000 companies. Our firm has been building a database of US guarding companies for the past 25 years, and has identified around 6,000 individual companies. We feel that our database is reasonably accurate to include just the individual companies. We believe this lack of consistent data results from: 1. In many states, security guard and investigative companies require the same SIC code; and there are thousands of one-to-two man investigative companies in the US.; 2. There is some duplicate counting – each branch office of a multi office national security guard company is counted as a single company.

In spite of the fact that the market is very large, it's also very fragmented and there's very little public information on the financial performance and the operating practices for the privately-held companies. We have, over the past 25 years, come to learn that this lack of public information is due primarily to the nature of the business and the owners' mindset. It is, after all, the security business, which by definition operates through a code of secrecy. There are no associations of private security guard companies that accumulate these operating statistics.

Number of Employees:

Also, an interesting fact is that there are approximately 1.5 million security officers in the U.S., about 2.5 times the number of public law enforcement personnel. If in fact the contract security guard market is getting more undesirable publicity than the public force – it could be primarily because the contract security guard market is so much larger than the public force, thereby a much larger "public opinion" target.

The Security Guard Market and the Recent Economic Downturn

While traditionally the security guard market has been viewed as recession proof, most security guard companies will feel at least a mild set-back through a prolonged recession. Typically, during a prolonged recession the security guard industry is among the last industries to go into the recession and the last to come out. Just how much a guard company is affected by the recession depends on how well financed the company was going into the recession and the vertical markets the company serves. For instance, most security guard companies depend on lines of credit to finance the growth and even the day to day operating cash needs. As the banks get more conservative in their loans, these thinly capitalized guard companies will experience increased loan costs or have their line of credit cut off altogether. Also, the guard companies that have customers that are adversely affected by the economy will lose volume, hence profits, as the customers look for ways to cut back and view security as a viable area of savings.

However, many of the guard companies actually experience growth in a bad economy as companies increase security to combat the increase in the crime rate that goes along with a financially challenging economy.

Factors Causing Growth and Contraction of Revenue in the Security Guard Industry

- ***Growth Factors***

  1. Companies looking to cut costs are eliminating their in-house security program and using contract guard companies. Typically, in-house security employees will have a higher pay scale due to long term tenure with the company and expensive retirement benefits. By contracting out the security function, companies are getting better trained security personnel in many cases, for less total outlay.

2. During a "down economy" the crime rate increases, thus companies looking to safeguard against the increase in crime are increasing their security coverage. This is particularly evident in the city and state municipal government sector; where there's a lot of pressure from the public to provide more protection.

3. As smaller companies have a difficult time operating due to cut-back in security from their customers and the line of credit becomes more expensive (or banks actually terminate the credit lines), these companies will go out of business or sell to their larger competitors. Although this does not cause growth in the overall market, it does cause a shift of the business from the small, thinly capitalized companies to the larger more financially robust regional, national or international security guard companies.

- ***Factors Causing Contraction***

1. Certain industries adversely affected by the downturn in the economy are closing locations, thereby eliminating the need for security once needed in those areas.

2. Some companies are eliminating contract security and using their own personnel to handle the security functions as a way to justify keeping the valuable employees.

3. Companies adversely affected by the economy are reducing the amount spent on security and taking on the risks of leaving the plant or premises vulnerable to incidents.

4. Some companies are trading security officers for electronic security. However, in most instances companies are not actually cutting back on manned security, but are supplementing the security function by installing cameras, alarms, etc. as a way to enhance the existing security. As a result many security guard companies are starting a separate electronics division or partnering with an existing electronics company.

Training, Background Checks and Drug Screening

The security guard industry has received much undeserved bad publicity about its quality of service and lack of hiring standards.

What most of the general public does not know is that many of the smaller companies and all of the larger ones administer drug tests as a condition to employment and have background verification more stringent than the state laws require. Also, many of the companies do psychological profile testing – a verification of the applicant's ability to handle the stress of security work and places the security officer in positions compatible with his/her personality traits.

Margins and EBITDA Matrix

Typically, the well run closely-held security guard company will have slightly better margins than its larger competitors. The reason is: 1. The smaller company is selling personalized service from the owner and many users of security guards are willing to pay extra for this personalized attention, and; 2. The smaller company operates in a limited geographic area or region; thereby cannot service the larger customers with multi national or international sites; and these "national accounts" are bid at lower margins in exchange for a larger volume of revenue going to the guarding company.

Below are the typical margins for the small, regional and national/international U.S. Security Guard Companies – with an insignificant portion of the revenue coming from the governmental sector (typically very low margin business):

	(1) Small Company	(2) Regional Company	National/International Company
Revenue	100%	100%	100%
Profit at site Level	20%	17 – 18%	13 – 14%
Profit at Branch Level		10 – 12%	10%
EBITDA	8%	7%	5-6%

(1) Revenues less than $10 million; owner manages the business and has customer relationships; operates from one office. Usually inefficient in back-office operation and pays more on a per unit cost for insurance, uniforms, etc.

(2) Revenues $10 - $100 million; owner less involved in customer relationships, operates multi-offices – usually volume $8 - $10 million per office.

Composition – by Company Size

		No. of Companies	Annual Revenue (in million $)
(1) (2)	Over $1 billion	3	7,000
(2)	$300M - $1B	3	1,600
(2)	$100M - $300M	11	1,600
(2)	$50M - $100M	5	350
(3)	$20M - $50M	16	600
(3)	$5M - $20M	200	2,000
(3)	$0 - $5M	7,762	4,850
		(5) 8,000	(4) 18,000

(1) 2 companies representing $5.6 B in revenue are foreign owned
(2) From June, 2009 issue of Security Letter
(3) Estimated based on information in files of Robert H. Perry & Associates, Inc.
(4) See "Information on the Size of the US Security Guard Market" – above
(5) Some sources put the size of the market as 10,000 – 14,000

Pricing Multiples for Large Transactions

The following summarizes the large transactions in the security guard industry for the past 10 years. Note that there's no consistency in reporting the assumption of long term debt when the companies made the announcement, thereby producing somewhat misleading conclusions on the total enterprise value price for some of the transactions. Also, in some cases – as in the Cognisa/US Security transaction – part of the purchase price was paid based on account retention post closing; and the amount of the post closing payment was not announced:

Pinkerton:

Sold February 1999 to Securitas
Volume $1 billion
EBITDA $33M
Price $407M
Multiple of Sales 40%
EBITDA Multiple 12.3 X

Burns:

Sold August 2000 to Securitas
Volume $1.5 billion
EBITDA $65M
Price $576M
Multiple of Sales 38%
EBITDA Multiple 8.9 X

Wackenhut:

Sold March 2002 to Group 4/Falck
Volume $2.8 billion
EBITDA $73M
Price $570M
Multiple of Sales 20%
EBITDA Multiple 7.8 X

Vance International:

Sold October 2002 to SPX
Volume $95 M
Price $67M
Multiple of Sales 84%
EBITDA Multiple – not announced

Allied Security: (now Allied/Barton)

Sold February 2003 to MacAndrews and Forbes
Volume $500+ M
Price $250+ M
Multiple of Sales 50%
EBITDA Multiple – not announced

Cognisa Security:

Sold August 2005 to US Security Associates
Volume $100 M
Price $40M
Multiple of Sales 40%
EBITDA Multiple – not announced

Vance International:

Sold January 2006 to Garda World Security
Volume $155 M
Price $67.25M
Multiple of Sales 43%
EBITDA Multiple – not announced

Initial Security:

Sold July 2006 to AlliedBarton
Volume $240 M
Price $73.6 M
Multiple of Sales 31%
EBITDA Multiple – not announced

AlliedBarton:

Sold July 2008 to Blackstone Group
Volume $1.5 billion
Price $750M
Multiple of Sales 50%
EBITDA Multiple –not announced

Vance International:

Sold June 2009 to Andrews International
Volume $128 M
EBITDA $4.5 M
Price $44.25 M
Multiple of Sales 35%
EBITDA Multiple 9.8 X

As can be concluded from the above analysis, most of the large announced transactions indicated purchase price values in the 8 – 10 times EBITDA range; or 40% of annual revenues. Many of the transactions have involved a larger security company buying its competitor, or in the case of Securitas buying Pinkerton, APS and First Security, the purchase was a way to get large in the US market quickly. What the announcements don't say is what the buyer's return on the investment was after considering consolidating advantages, elimination of redundant costs, etc.

In the case of investment groups buying a large security guard company as a way to enter the market, the multiples paid were at least as high as what the industry buyers were paying, even though the investment group's return on investment in the short term was not as attractive as the industry buyers were getting. However, they had to be competitive in the bidding process for the initial buy. As they made future acquisitions, their returns became a lot more attractive, especially if the acquired company folded into the flagship company's operations – thereby through averaging the prices paid for the multiple purchases, the return on the initial purchase became a lot more attractive.

Pricing Multiples for Small Transactions

As for the smaller privately-held company sellers, the prices paid expressed as a percentage of annual revenue seem to be about the same as the larger transactions. However, the multiples of the sellers' reported EBITDA are much larger for the smaller transactions than the larger transactions.

When we look at the sellers we've represented over the past 3 years with revenues in the $5 - $50 million range, the prices paid averaged 42% of annual revenue – to include a normal level of unleveraged working capital. The unleveraged working capital will usually be around 8% of annual revenue if the days outstanding for the accounts receivable average around 45 days, and the company pays its security officers on a bi-weekly basis.

Although this 42% usually represents a large premium against the SELLERS' EBITDA, it can be an attractive buy for the buyer.

A case in point is the sale we recently managed for the owners of a $15 million northeast based security guard company. The selling price was about 13 times the **seller's** adjusted EBITDA. However, the buyer showed about 4 – 5 times its pro-forma EBITDA since the buyer was able to eliminate a lot of redundant cost in consolidating the operations – such as billing clerks, payroll clerks, costs of duplicate offices, etc. Additionally, the buyer, being a multi-billion dollar conglomerate, was able to buy insurance and uniforms (a large expense item for security guard companies) at a much lower per item rate than the seller.

Investment Groups Making Investments in the Security Guard Market:

As a result of the deteriorating returns for companies in general, many Private Equity Groups (PEG's) are now looking to the security guard market as investments of choice. Although the security guard industry is growing at an unexciting rate of around 5% per year, it is, in fact, growing; while most of the industries are shrinking. Some well known Private Equity Groups with significant investments in the security guard industry are: 1. The Blackstone Group (www.blackstone.com) has a significant investment in AlliedBarton (approx. $1.5 Billion in annual revenue); 2. The Audax Group (www.audaxgroup.com) has a significant investment in Andrews International (approx. $350 million in annual revenue); 3. Windpoint Partners (www.wppartners.com) has a significant investment in US Security Associates (approx. $700 million in annual revenue); 4. Pegasus Capital Advisors (www.pcalp.com) has a significant investment in T & M Protection Resources (about $100 million in annual revenue); 5. Trivest (www.trivest.com) owns Allegience Security Group (approx. $60 million in annual revenue).

As mentioned earlier, investment groups typically see a lower return on their initial investment in the industry since they don't have the advantage of synergistic savings when making a transaction. However, as the groups make future acquisitions that are "fold-ins" to their existing flagship portfolio company, the returns are much more attractive. When all the investments are averaged, the return on the initial purchase becomes much higher.

The Pros and Cons of the Investment Groups Getting Into the Security Guard Industry are as Follows:

***Positives*:**

1. There are still many consolidating opportunities left for investment groups wanting to get large in the industry through a series of acquisitions. [See previous chart of "Composition – by Company Size"] Typically, the investment group will have to pay around 8 - 10 times the sellers' adjusted EBITDA to get into the business, then can make the "tuck-in" acquisitions for EBITDA multiples (off the buyer's pro-forma profit calculation) in the 5-6 range; on an enterprise value basis.
2. The multiples for the resale of the companies when the investment groups make their exit have been and still are very attractive.
3. The security guard industry, in terms of future growth prospects, is much better that the general population of investment opportunities for Private Equity Groups.

***Negatives*:**

1. The security guard business is a target for lawsuits – workers compensation, employee harassment, equal opportunity workers violations and general third party claims (theft, harassment, destruction of premises, accidents, etc.).
2. Labor intensive – frequent target for unions, unemployment law changes, new training requirements, etc.
3. Low barrier to entry. Presently the states mandate the laws required to enter the security guard business and in some states all that is required is a $40 business license.