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Why Are Buyers Paying Such High Multiples for Security Guard Companies That are Only Marginally Profitable, or Losing Money?

For many years, owners of privately held security guard companies were relying on the “street formulas” to get an idea of what their company might be worth to one of the generous industry buyers should they decide to put the company on the market. These formulas were based on gross units such as multiples of gross revenue or percentage of annual billing. These calculations were believed to be about 25% of annual revenue or three times gross monthly billings. However, over the past few years, these multiples have become very unreliable. Security guard companies may sell for much more than these traditional formulas, or to the surprise of many owners looking to sell, their company may not be saleable at all.

Buyers today first decide whether or not they are interested in the company based on several factors – such as geographic location, types of accounts, margins, etc. If the seller passes this initial test, the buyers then do a return on investment computation. This will tell the buyer what they can make off the acquisition and is the basis for their offer. And to prove how unreliable the old “street formulas” are, we’ve seen the prices, stated in terms of gross units, as low as 2.5 times gross monthly revenue (20% of annual gross) to as much as six times gross monthly revenue (50% of annual gross) – plus the book value of the company. These offering prices, when converted to multiples of the SELLER’S earnings, are often in the mid double digits, or off the charts in the case of sellers actually losing money.

How can these buyers pay so much for these marginally profitable companies? They make the company more profitable than it was in the hands of the seller. They do this by eliminating redundant costs and by reducing operating costs through volume buying. And, contrary to what a lot of nervous owners believe, many of the expense savings do not come from changing the seller’s company. Many result from the buyer’s ability to be more efficient now that it has a much larger volume of business in its operating area. For instance, the buyer may move its operations to the seller’s office, thereby eliminating the rent the buyer was paying on its space; or the buyer may move the accounting to the buyer’s home office, eliminating a few clerks. The buyer also will probably have insurance rates much lower than the seller’s; and the cost of borrowing money will be much lower. When all these savings are figured in, the buyer will usually wind up paying around five to seven times the BUYER’S proforma profit from the acquisition – albeit a much larger multiple on the SELLER’S reported profits.

Author

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