WHITE PAPER ON THE U.S. SECURITY GUARD INDUSTRY

MARKET ◆ MARGINS ◆ MULTIPLES

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Defining the "Private Security" Market

The use of the words "Security Guards" or "Guarding" are gradually disappearing in how security companies, that provide these services, describe themselves – resulting from an increasing menu of types of security offered and an attempt to differentiate themselves in the marketplace. Today, many companies that have a significant amount of revenue coming from the traditional guarding sector are calling themselves "Private Security" or "Contract Security" companies (or some other derivative of these terms). These comments are underscored by a recent ***Security Systems News*** article that described G4S' trend in bundling services like traditional guarding, monitoring and systems integration services; leading to G4S to now label itself as a "Security Solutions" company. It's interesting to note that on G4S' website it describes its humble beginnings as starting from offering "night watchman" services.

The RTI International Report:

In late 2010, the Department of Justice funded a research project conducted by RTI International in the Research Triangle Park area of North Carolina. The very comprehensive 100-page report is titled: "**The Private Security Industry: A Review of the Definitions, Available Data Sources, and Path Moving Forward".** The full report can be viewed at [https://www.ncjrs.gov/pdffiles1/bjs/grants/232781.pdf].

The report cites the 1970's RAND corporation report for the definition of private security as "all types of private organizations and individuals providing all types of security-related services, including investigation, guard, patrol, lie detection, alarm, and armored transportation" (Kakalik & Wildhorn, 1971b, p. 3).

The report also cites the Green (1981) report that said … [definitions of private security] based on profit orientation or source of funds are not useful because nonprofit institutions, such as hospitals, airports, and schools, often hire private security. Green went on to define private security as "those individuals, organizations, and services other than public law enforcement agencies, which are engaged primarily in the prevention of crime, loss, or harm to specific individuals, organizations, or facilities" (as described in Cunningham et al., 1990).

The RTI report cites American Society for Industrial Security (ASIS) as defining private security as "the nongovernmental, private-sector practice of protecting people, property, and information, conducting investigations, and otherwise safeguarding an organization's assets" (ASIS International, 2009a). ASIS further argued that private security has a role in "helping the private sector secure its business and critical infrastructure, whether from natural disaster, accidents or planned actions, such as terrorist attacks, vandalism, etc." (ASIS International 2009 b).

Menu of Services

The above are just a few of the resources RTI used in developing its report on how the industry defines itself. What is clear from the report and what we are seeing in the industry is that most of the companies that used to actually call themselves "guard companies" are now using various versions of terms such as "Private Security Companies" as a broad term of identifying the services they now offer. As previously mentioned, this is because many of the companies are trying to differentiate themselves from their low/bill, low/pay rate "so-called" competitors and the menu of services they are offering has drastically expanded; even though traditional guarding still makes up the vast majority of the revenues for these companies.

A review of the websites of many of the major "Private Security Companies" indicates that terms such as "Professional Security Personnel", "Unarmed (or armed) Security Officers", "Private Security Professionals", or several derivatives of these terms, are being used to describe what used to be called "Security Guards".

Many of these companies go on to identify the various other services they offer (which again, differentiates them from the traditional "Security Guard Company"), such as:

- Special Event Security
- Risk Analysis
- Security Consulting
- Loss Prevention
- Investigators
- Background Screening
- Facility Design
- Roving Vehicle Patrol Services

Robust Activity in Mergers and Acquisitions Since July 2010

Below is a summary of some of the significant ANNOUNCED transactions – pertaining mostly to the guarding, cash-in-transit and electronics sector of the security industry. The list includes foreign as well as domestic transactions for international companies with a significant U.S. presence. This expanded list certainly indicates that the buyers have been very busy in the past 12 months and there does not seem to be any slow down in sight – as evidenced by the July 29, 2011 purchase of WindPoint Partners' interest in U.S. Security Associates (a $900 million company) by Goldman Sachs.

- ***July 29, 2011 –*** **Wind Point Partners, a private equity investment firm based in Chicago, announced today that it has sold one of its portfolio companies, U.S. Security Associates, to affiliates of Goldman Sachs Capital Partners.** U.S. Security provides security services to over 3,000 clients, with 146 branches across the United States and Puerto Rico.

- ***July 19, 2011 -*** **Stanley Black & Decker gains U.S. Antitrust clearance for acquisition of Niscayah,** a Swedish security products company. The offer trumps the previously submitted bid by Securitas to buy back the company.

- ***June 27, 2011 –*** **A consortium of private equity buyers including Bain Capital and Hellman & Friedman lead on £2.1bn (Euros) private equity purchase of Securitas Direct (leading European alarm company).**

- ***April 15, 2011 –*** **Paragon Systems, Inc. (a subsidiary of Pinkerton's Government Services, Inc.) within the Securitas Group has agreed to acquire Security Consultants Group, Inc. (SCG) in the U.S.** SCG offers high level, armed security officers to various US Government agencies. Paragon paid $22 million for SCG, which had revenues of $106 million.

- ***April 13, 2011 –*** **Blackstone Group announces plans to buy Securitrans (New Dehli based) from the APS Group.** Securitrans provides security cover for large commercial banks during transportation of cash and other valuables. Blackstone also owns the majority of AlliedBarton – a $1.7 billion security company operating in the U.S.

- *April 08, 2011* – **G4S Secure Solutions (UK & Ireland) acquired the Cotswald Group, the UK's market leader in surveillance, fraud analytics, intelligence and investigative services.** "Adding to similar services offered in the U.S., Middle East and Asia Pacific, with this acquisition G4S will become the global leader in the investigations of insurance fraud…"

- *March 31, 2011* – **The U.S. subsidiary of Swedish based Loomis has agreed to acquire the cash handling business of Pendum, LLC for $100 million.** Pendum's cash handling revenues were approximately $100 million. The ATM maintenance and repair business is not being bought by Loomis and will remain with Pendum.

- *February 17, 2011* – **ISS announces its plans to go public on the Copenhagen exchange.**

- *February 17, 2011* – **Garda Security Group agreed to acquire privately held Kolossal Security, one of Canada's largest privately held security services providers.** Garda paid $6.95 million ($4.25 million at closing) for Kolossal's $65 million in annual revenues.

- *January 14, 2011* - **Securitas agreed to buy Chubb Security Personnel in the United Kingdom.** The purchase price was 31 million British Pounds and Chubb's revenues were 113 million British Pounds.

- *December 23, 2010* – **Brink's buys Threshold Financial Technologies, Inc. for $40 million – revenues of Threshold were $48 million.** Threshold is a leading provider of payments solutions, specializing in managed ATM and transaction processing services for financial institutions and retailers throughout Canada.

- *November 10, 2010* – **Securitas purchases Reliance Security Services in the United Kingdom.** Revenues of Reliance were 200 million British Pounds and the purchase price was 43 million British Pounds.

- *November 10, 2010 –* **Brink's acquires Mexico's largest secure logistics company, Servicio Pan Americano de Proteccion, S.A. de C.V., for approximately $60 million.**

- *August 2, 2010 -* **Universal Protection Service Acquires Shield Security and Bower Security, Inc.** With about $40 million in revenue, Shield and Bower Security employed close to1,500 security officers throughout California and have been providing security guard services since 1964.

- *July 13, 2010 –* **G4S Secure Solutions USA acquires NSSC – this acquisition further supports G4S' commitment to expand its menu of security offerings to its existing and future customers.** Drew Levine, president, G4S Secure Solutions says of this acquisition…"our acquisition of NSSC further broadens our ability to deliver truly integrated security unlike any other company in the industry…"

Size of the US Security Guard Industry

The matrix making up the number of companies in the market continues to indicate a very fragmented market, with a few large companies controlling the majority of the gross revenues for the industry.

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 are saying that today's security guard market, to include only traditional guarding services, is in the $17 - $18 Billion range; almost no change since our last report. Therefore, we'll use $18 Billion as we describe the industry throughout 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 1 report indicating 14,000 companies. We believe this lack of consistent data results from: 1. Consolidating other services in the traditional guarding category - 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. Duplication in counting – some reporting agencies are counting a branch office, of a multi-office national security guard company, as a single company. Our firm has been building a database of U.S. 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.

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 under a code of secrecy. There are no associations of private security guard companies that accumulate and publish financial statistics on the industry.

Composition – by Company Size

		No. of Companies	Annual Revenue (in million $)
(1) (2)	Over $1 billion	3	7,175
(2)	$300M - $1B	4	1,885
(2)	$100M - $300M	10	1,500
(2) & (3)	$50M - $100M	3	168
(2) & (3)	$20M - $50M	13	509
(3)	$5M - $20M	200	2,000
(4)	$0 - $5M	7,767	4,763
		(6) 8,000	(5) 18,000

(1) 2 companies, representing $5.2 B in revenue, are foreign owned
(2) From July 2011 issue of *Security Letter* [adjusted for Canadian companies]
(3) Estimated based on information in files of Robert H. Perry & Associates, Inc.
(4) Arithmetical function to come to the 8,000 companies and $18B revenue
(5) See "Information on the Size of the US Security Guard Industry" – on page 6 of this report.
(6) Some sources indicate the number of companies as 10,000 – 14,000

Number of Employees

An interesting fact about the security guard industry 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 how much the vertical markets the company serves are affected by the downturn.

Banking Relationships

Since our last report in July 2010, we have heard from several security guard company owners regarding their present banking relationships. The situations described by these owners do not present a clear picture of what's happening to the banking relationships across the board. Some of the companies have had to change banks because their present bank called their credit line. Other companies had increased borrowing costs, but remained with their present bank.

A June 30, 2011 article in the Wall Street Journal painted a very dismal picture for the general population (not specifically security companies) of small to medium sized companies seeking loans in today's market. The article went on to say that the loans as of March 2011 were almost 9% less than the loans for the same time in 2010 – loans from large banks fell 14%, while loans from smaller banks fell only 3%. In a survey to the larger companies (revenues greater than $25 million) only 37% of those responding to the Journal's survey indicated success in securing bank loans in the past six months, despite the Federal government's mandate to the banks to loosen their credit standards. According to the Pepperdine study [cited in the Journal article], more than three-quarters of bankers said they felt increased pressure from regulators, and 61% of those bankers reported that they have rejected loans they otherwise would have made to please the federal overseers.

Some Security Guard Companies are Growing

Some of the guard companies are actually experiencing growth in this bad economy as customers increase security to combat the increase in the crime rate that goes along with a financially challenging economy. Also, many of the security guard companies (especially the larger ones) are introducing new, and more profitable, services as a way to win new accounts or keep existing ones; such as the bundling of services by G4S as mentioned earlier in this *White Paper*. In fact, many of the larger companies are getting into the remote video monitoring business as a way to supplement or enhance the existing traditional standing guard service. Some are also pursuing the background screening business, "Alert Line" services, executive protection, etc. – all as a way to diversify and get more competitive and, in a lot of instances, set themselves apart from their strongest competitor in the traditional standing security guard market.

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

- ***Growth Factors – many reports still indicate that the security guard market in the U.S. will continue to grow in the low to mid single digit range for the next three years:***

  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 a cut-back in security from their customers and increased line of credit costs (or banks actually terminate the credit lines), more of these companies will go out of business or sell to their larger competitors. As a case in point; a recent mass mailing our firm made to our database of security guard companies, resulted in a record number of the letters being returned with an indication that the company was "out of business". 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. An article in the July 2011 issue of *Security Director News* cited a police department in a New Jersey city that installed video equipment to supplement its police force. This could point to a trend that will carry over into the private security sector. 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, and as mentioned above, 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 perform 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 small to medium sized security guard company will have better margins than its larger competitors. The reasons are:

1. The smaller guard company is selling personalized service from the owner and many users of security guards are willing to pay extra for this personalized attention.

2. The smaller guard company operates in a limited geographic area or region; thereby cannot service or attract the larger customers with multi national or international sites. These "national accounts" are mostly handled by the larger national or international guard companies; but the competition to win these type customers is very intense. Therefore the large guard companies will bid these accounts at much lower margins (than the smaller companies are getting for their "local" accounts) in exchange for a larger volume of revenue, the prestige of providing security for some well known conglomerate, or the possibility of obtaining additional sites or other types of security for this conglomerate at much higher margins once the guard company gets its foot in the door.

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). Our firm has not seen a significant change in the margin matrix since the July 2010 White Paper report. However, there are concerns in the industry that the future margins will be adversely affected by the rapidly increasing unemployment tax rates (already having a dramatic impact on many companies) and the perils coming from the New Healthcare Bill that come into full effect in 2014.

	(1) Small Companies	(2) Regional Companies	National/International Companies
Revenue	100%	100%	100%
Profit at site Level	18%	15 – 17%	12 – 14%
Profit at Branch Level		10 %	9%
EBITDA	7%	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. Margins are slipping due to the competition from the larger security guard companies having more interest in the smaller, higher margin accounts; margin pressures from existing customers due to the downturn in the economy.

(2) Revenues $10 - $100 million; owner less involved in customer relationships, operates multi-offices – usually volume is $5 - $10 million per office. Margins are slipping due to the competition from the larger companies and client pressure to maintain or decrease billing rates; while direct costs are increasing.

Overview of Worldwide Completed Transactions

There were 65 ***announced*** worldwide completed transactions in 2010, compared to 56 in 2009 and 59 in 2008. It's interesting to note that there were 4 ***announced*** guard company transactions in the United Kingdom in 2008, 1 in 2009 and 9 in 2010. We believe the significant increase in transactions in the United Kingdom resulted from the UK recession issues described in *Security Management Today's* overview of the 2011 Plimsoll report - click here to view the SMT article.

Also of interest is the number of guard company transactions: On a worldwide basis, the number of guard company transactions represented about 50% of the total transactions. And nearly half the transactions were for U.S. based sellers; not surprising, since the U.S. has the largest security market in the world.

	2010				
	Q1	Q2	Q3	Q4	TOTAL
Guarding	5	10	6	10	31
Alarm Monitoring	2	4	4	5	15
Systems Integration	3	2	5	4	14
Other - Investigative, Armored Car, etc.	1		2	2	5
Total Announced Transactions	11	16	17	21	65

	2009				
	Q1	Q2	Q3	Q4	TOTAL
Guarding	6	4	6	8	24
Alarm Monitoring	5	2	4	8	19
Systems Integration	1	0	2	3	6
Other - Investigative, Armored Car, etc.	2	2	0	3	7
Total Announced Transactions	14	8	12	22	56

2010					
Country	*Guard*	*Alarm Monitoring*	*Systems Integration*	*Other*	*TOTAL*
Bangkok			1		1
Bosnia		1			1
Canada				1	1
Denmark		1			1
Mexico				1	1
Montenegro	1				1
Poland	1				1
Romania	1				1
Singapore	1				1
South Africa	2		1		3
Sri Lanka	1				1
Thailand	1				1
United Kingdom	9		1	1	11
United States	14	13	11	2	40
TOTALS	31	15	14	5	65

2009					
Country	*Guard*	*Alarm Monitoring*	*Systems Integration*	*Other*	*TOTAL*
Anglia	1				1
Argentina	1				1
Brazil				1	1
Chile	1				1
China	1		1		2
Colombia	1				1
Czech Republic	1				1
Estonia			1		1
France	2		1		3
India			1		1
Mexico	2				2
Morocco	1				1
S. Africa	1				1
Serbia	1				1
Spain	1	1			2
United Kingdom	1	1		1	3
United States	8	17	2	5	32
Vietnam	1				1
TOTALS	24	19	6	7	56

Selling Prices for Large Security Guard Company Transactions

The following summarizes the large **announced** transactions for the past 12 years for US sellers offering primarily contract security officer (guarding) services. 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.

	Company Sold	Buyer	Revenue	EBITDA	Price	Price as Multiple Revenue	Price as Multiple EBITDA
1999							
	Pinkertons	Securitas	$1B	$33M	$407M	40%	12.3x
2000							
	Burns	Securitas	$1.5B	$65M	$576M	38%	8.9x
2002							
	Wackenhut	Group4/Falck	$2.8B	$73M	$570M	20%	7.8x
	Vance International	SPX	$95M	N/A	$67M	84%	N/A
2003							
	Allied Security	MacAndrews & Forbes	$500M+	N/A	$250M+	50%	N/A
2005							
	Cognisa	U.S. Security Associates	$100M	N/A	$40M	40%	N/A
2006							
	Vance International	Garda World	$155M	N/A	$67.2 M	43%	N/A
	Initial Security	AlliedBarton	$240M	N/A	$73.6M	31%	N/A
2008							
	AlliedBarton	Blackstone Group	$1.5B	N/A	$750M	50%	N/A
2009							
	Vance International	Andrews International	$128M	$4.5M	$44.25M	35%	9.8x
2010							
	* Paragon Systems, Inc.	Pinkertons Government Svcs	$140M	N/A	$34.5M	25%	N/A
2011							
	* Security Consultants Group	Paragon Systems, Inc.	$106M	N/A	$22M	21%	N/A

N/A = not provided in the announcement

* These are the only announced transactions for a major provider of security guard services to the Federal Government. Typically, the margins for Federal government accounts are less than traditional commercial accounts, thus the selling multiple as a percent of revenue is less than the industry average for traditional commercial accounts.

As can be concluded from the previous 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. The announcements do not indicate 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 enjoying. However, the investment groups had to be competitive in the bidding process for the initial buy. As the investment groups made future acquisitions through the flagship company, 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.

Selling Prices for Small Security Guard Company Transactions

It's a Seller's Market:

The large security guard companies, which are usually the most generous on pricing, need to grow to replace some of the business lost in the downturn of the economy. The very large companies are finding it difficult to maintain its 5% - 8% **net** growth through internal sales alone; they need to make acquisitions of smaller companies in order to meet these growth targets and keep the stockholders happy. The generous buyers presently have an abundance of cash on their balance sheet that they need to put to work; and buying smaller companies that they can make more profitable through eliminating redundant costs makes for the most prudent use of their idle capital.

Also, as stated earlier, the smaller companies are a particularly good acquisition target for the larger conglomerates because the margins for the smaller companies tend to be 5 – 8 points higher than the average margins for the customers of the larger companies.

The prices being paid for the smaller companies over the past two years, expressed as a percentage of annual revenue, are about the same as the larger transactions; and in some cases, for strategic acquisitions, are much higher. However, the multiples of the **sellers'** reported EBITDA are much higher for the smaller transactions than the larger transactions, since the buyers in the security guard industry give the seller credit for the redundant cost savings that benefit the buyer in the transaction.

For many years, and unfortunately even today, many owners thinking about selling are still using the traditional "street formulas" as a way to estimate the eventual selling price of the company. These "street formulas" use multiples of gross units (percentages of gross annual revenue or multiples of gross monthly billing) as a way to put an estimated value on the company. However, these street formulas usually result in the company being grossly over-priced or, worse yet, under valued. When we look at the transactions we've managed over the past two years for companies with volumes between $5 million and $150 million, the selling multiples, as a percentage of annual revenue, were as low as 20% to as high as almost 50% of revenue, for just the accounts (i.e.; if the buyer purchases the balance sheet items, these items are added to the price based on the balance sheet carrying value).

In fact, the "street formulas" were never used by most of the experienced buyers. These buyers use the profit at the account site level (which determines the buyers' economic return on the acquisition), coupled with the attractiveness of the accounts, quality of management going with the sale, geographic location of the accounts – along with several other characteristics important to buyer prospects.

Why Owners Are Not Rushing To Put The Company On The Market, In Spite of Shrinking Margins and Revenue:

In Volume 15, No. 1 of our issue of *Notebook of Ideas for Divestitures of Security Guard Companies*, we mention four reasons owners are not putting their company up for sale now:

1. **Owners consider the industry recession proof:** Security guard company owners see continuing activity in the market, so they are taking a "wait and see" approach to selling, thinking that buyers will still be there when they get ready to sell.

2. **Decline in alternative investment opportunities:** Before the recent economic downturn raised its ugly head, many sellers of security guard companies made more money from the funds they invested from the sale of the company than they made while owning and operating the company. However, with the dramatic drop in real estate values, and money markets and the stock market declining so dramatically, doing this safely and profitably in the current economic climate would be very difficult.

3. **Owners have not yet "tested" their credit lines:** Many of the more fortunate security guard companies established or renewed its credit lines back when the banks were eager to please and more anxious to lend money, and the credit line will not come up for renewal for several more years. Most are still safe with their loan terms and have not actually talked with their bank about what to expect come renewal time. They feel reasonably but cautiously optimistic that their banks will continue to support their financial needs.

4. **Some companies have already lost value:** Some of the security guard companies have, in fact, already felt the effects of this challenging economy and have lost value – not because the selling multiples have gone down, but because the company has lost valuable and profitable revenue. The owners do not want to have to sell for a reduced price because they still have high expectations, so they are waiting for the economy to turn around before they think seriously about selling.

Private Equity Groups Making Investments in the Security Guard Industry

There has definitely been an uptick in the Private Equity Groups' interest in the security guard sector in the recent months. Typically, the life of a single fund for a Private Equity Group is around 10 years. Collectively, the Private Equity Groups raised a record amount of commitments during the years 2005 – 2007 and because of the downturn in the economy they're behind on putting these funds to work for their investors. Some estimate the size of the idle cash to be several hundred billion dollars. The Private Equity Groups are now scrambling around to find viable investments that will give their investors an attractive return and are looking to the security industry as investment possibilities.

While most of the Private Equity Groups are interested in the high margin side of the security sector (i.e.; biometrics, electronic security, etc.) some are looking at **large** security guard companies (even though the industry is expected to grow at an "unexciting" rate of around 3% per year) as a platform from which to build for the next 5 years; then sell at the end of the 10-year life of the fund. There are presently several large security guard companies "ripe" to be acquired by Private Equity Groups; one transaction (U.S. Security Associates/Goldman Sachs) was completed right before this *White Paper* went to press.

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. $1.7 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. *Goldman Sachs* (www.goldmansachs.com) has a significant investment in US Security Associates (approx. $900 million in annual revenue). Goldman Sachs purchased WindPoint Partners' ownership on July 29, 2011.

4. *Pegasus Capital Advisors* (www.pcalp.com) has a significant investment in T & M Protection Resources (about $125 million in annual revenue).

5. *Trivest* (www.trivest.com) owns Allegience Security Group (approx. $60 million in annual revenue).

6. *LaSalle Capital* (www.lasallecapitalgroup.com) started United American Security LLC in April 2010, through the simultaneous purchase of 3 existing companies – Industrial Security, Inc., Leonard Security Services, Inc. and Eagle Security, Inc.

As mentioned earlier, Private Equity Groups typically see a lower return on their initial investment in the industry since they do not have the advantage of synergistic savings when making this initial acquisition. 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 positive aspects of the security guard industry for Private Equity Groups:

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 (or even higher) the ***sellers'*** adjusted EBITDA to get into the business, then can make the "tuck-in" acquisitions for EBITDA multiples (from the buyer's pro-forma profit calculation) in the 5-6 range.

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 than the general population of investment opportunities for Private Equity Groups.

The negative aspects of the security guard industry for Private Equity Groups:

1. **Target for lawsuits:** Since the security guard companies are labor intensive, they are prime targets for 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, low paid employees, constant changing training and hiring 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.

Future Challenges for Owners of Security Guard Companies

In the past 12 months, there have been many developments that have been announced that will, or may, take place in the coming years that will have a dramatic effect on owners of security guard companies:

New Healthcare Bill

Everyone in the industry is aware of this provision, but hardly anyone knows its real impact on their particular company. The general consensus is that it will certainly increase operating costs. Many owners say they will be able to pass all or part of this cost increase onto their customers; but they are saying this with reservation. They admit that some customers cannot, or will not, accept the price increase; which will result in lost customers, decrease in billing hours; or decrease in the guard company's earnings, in the case where the guard company has to absorb the additional cost.

Further Unionization of the Security Guard Industry

In early 2010, President Obama, in a recess appointment, appointed a SEIU lawyer to head up the National Labor Relations Board. This, coupled with several news articles surrounding the SEIU's connection to the White House (the frequent visits by SEIU executives and the large financial support to President Obama's election campaign), gave security guard company owners great concern over the gaining strength and influence of the unions and their continuing heavy handed approach to unionization. Recent reports indicate the unions' attempt to establish union work forces through a "card check" procedure (making it much easier for the unions to get certified), as well as allow part time employees to join the union and the use of corporate e-mails for organization efforts.

Increase in Federal Income, Capital Gains and Inheritance Taxes

Because of the heavy Federal deficit, the Federal Government is looking for ways to bring more money back into its coffers. Unfortunately, the business owners and the high earners will be paying its "unfair" share of helping restore the treasury. The Bush tax cuts that were set to expire at the end of 2010 have been extended, but eliminating these concessions and raising several types of taxes are inevitable. If the tax increases are put into effect (or some of the present cuts are not extended, again) high income earners will pay more Federal income taxes, businesses will pay higher taxes on payroll and heirs of decedents will be facing a much larger inheritance tax.

Also, business owners selling their company will pay a lot more taxes on the sale. In a recent article our firm published on this subject, it was pointed out that if the capital gains taxes go back to just 20% (from the present 15%), the company will have to be about 7% larger just for the owner to net the same dollars as it would have netted had it sold the company before the tax increase. However, this probably gets worse: there's mention of a 3.8% tax on investment income exceeding $250,000; which if enacted will make the effective capital gains rate in the 25% range; which means the company would have to be about 13% larger in order for the seller to net the same as it would if the owner had sold the company at the present tax rates.

Higher Unemployment and Other Taxes

Owners of large and small companies are experiencing very large increases in unemployment taxes as a result of the US high unemployment rates – which presently does not have any significant improvements predicted for the near future. As state unemployment funds continue to diminish, the rates will continue to rise – already approaching double digits in some states.

Also, many municipalities are trying to pass legislation to tax services (not presently subject to sales tax) in an effort to make up for the diminishing tax based revenue resulting from the diminishing economy. This sales tax is usually passed on to the customer contracting for the security, but it definitely impacts the customer's cost of security, which in turn puts pressure on the customer to ask for price concessions from the security service provider.

ABOUT ROBERT H. PERRY & ASSOCIATES, INCORPORATED:

Established in 1977, Robert H. Perry & Associates, Incorporated is a specialized acquisition and merger firm focusing on the security industry. Our firm has initiated and managed transactions for over 150 sellers located throughout North and South America, Western Europe, the Caribbean, and the Middle East.

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