What's Up and What's Down in Security Industry M&A

What's the outlook for mergers and acquisitions? Sandy Jones, principal, Sandra Jones & Co., answers the question with a description of M&A activity in three industry segments—dealers, systems integrators, and manufacturers.

Dealers

M&A activity is strongest for alarm dealers because these companies' recurring monthly revenue (RMR) provides steady cash flow that adds profits and finances operations. "Transaction multiples held at traditional values through January 2009, but there were fewer deals," says Jones. "Since February, multiples have declined, but not as steeply as in other segments. The companies that don't have to sell are withdrawing and staying the course. Those that do have to sell are doing so, often at lower prices." While M&A activity in this sector remains the least affected, there are other challenges impacting transactions. "Public company stock prices are down, cash is being conserved, and attrition is a concern as costs increase to retain current RMR levels and attract new subscribers," describes Jones. "These factors will impact future deals and pricing."

Sandy Jones

"While there is a significant downside, every economic climate holds opportunity."

Sandy Jones, Sandra Jones & Co.

Systems Integrators

The situation for systems integrators is less positive. "M&A activity for companies under $10 million has evaporated," continues Jones, "except for integrators that have scale, strong service components, and new capabilities. We don't expect many transactions in this sector, but we think new technologies will enable more systems integrators to add recurring revenue services that can increase their desirability as acquisition targets. Competitors in a geographic area may consider merging to cut costs and create a more valuable company. And integrators are focusing harder on profitability. In 100 percent of the financial assessments we've conducted, we've found lost profits. No one can afford that, especially in this economy."

Manufacturers

Jones forecasts more manufacturer consolidation, reflecting a glut of technology and redundancy in the market. "The time is right for further consolidation at every level," she notes, "as evidenced by Panasonic's purchase of Sanyo in a $9 billion deal that creates one of the world's largest electronics companies and strengthens Panasonic's position in the fast-growing green energy arena."

Jones adds that acquisition isn't the only road to manufacturer growth. "The industry has been learning to partner and I expect to see more strategic alliances and partnerships formed. You can see it at ISC West, where major manufacturers like IBM share their booths with business partners to demonstrate the full range of solutions they offer.

"While there is a significant downside, every economic climate holds opportunity," summarizes Jones. "But customers demand value and, as an industry, we have to be creative in how we provide it. Security as a Service (SAAS), managed services, and Monitoring as a Service (MAAS) are profitable growth areas that enable companies to add real value to customers and improve profitability."

Follow the Money

Excerpts from the November 2008 Securing New Ground financial panel.

WALTER BAILEY, managing member, EpiGroup, said "The days of 15 percent or less equity dollars in a deal are gone. Now it's 50 percent. The S&P 500 companies have more cash on their balance sheets than in recent history. They're not using it, but they have it. Portfolio managers will be making new investments and liquidity will be opening up. Deals are getting done with companies that have strong balance sheets, business position, and cash flow."

Walter Bailey

ROBERT CHEFITZ, general partner, Egis Capital Partners, said "Security is more compelling than almost any other industry today. It has strong growth relative to other industries." He noted that it takes about six months to raise money. "You must have a clear business plan with a compelling executive summary and defensible model. There are tremendous amounts of capital looking for the kinds of companies that many in the security industry are building."

Robert Chefitz

JOHN MACK III, managing director, Imperial Capital, said "We can expect to see fewer M&A deals and lower valuations. We'll see more stock as a component of transactions and less cash and lower leverage. More deals will be done by strategic buyers. This adds up to a big buyside opportunity to buy incredibly valuable businesses at lower valuations. We may never see this opportunity again in our lifetime."

John Mack III

BILL POLK, managing director, CapitalSource, said the global financial crisis has affected every capital market. "But strategic and financial buyer interest remains strong and they have large capital reserves. The convergence of security and IT continues to drive new public and private sector spending. Certain industry subsectors, especially government contractor, security alarm, and corrections, have experienced lenders. Industry credits generally remain sound."

Bill Polk

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