HARDING
SECURITY SERVICES INC.
UNLOCKING OPPORTUNITIES IN THE SECURITY INDUSTRY

Tips to keep in mind when Valuing your Business

Like many of the subjects in my articles, there are endless amounts you can write about on the ins and outs of getting your business valued. Below are just some of the things I have learned about valuing security companies over the last 10 years.

1. **Valuations can vary like crazy –** A company's valuation is like what they say about beauty. It is in the eye of the beholder. A company's value can vary a great deal depending on who is looking at it. 5 years ago I sold a well known alarm company for $2.2 million when the next best offer we had was only $1.3 million. Valuations can vary depending on the buyer. This is why it is so important when selling a company that you approach as many of the good buyers as possible. The Canadian market for security companies which is much smaller and less competitive than the US market can be affected by the arrival or disappearance of one or two key buyers

2. **Valuations change over time-** The value of alarm accounts in general in Canada and the US has dropped over the last two years because of higher than expected attrition experienced by accumulators and a greater Cost to Create new accounts. Another example is I am noticing that the interest and values attached to Canadian fire companies has increased due mainly to the arrival of some private equity firms into the fire market.

3. **Always get a current valuation done before you sell-** You would not sell your house without getting a ballpark figure on what it is worth before you put it up for sale. And don't delude yourself into thinking you already know what your business is worth. My experience is that most owners of small businesses think their business is worth more than it really is. I can't tell you how many alarm accounts owners I have run across who all think their accounts are automatically worth 36 months of revenue. I will not embark on a sale process without giving my client a ball park estimate of what the business is worth at the very least.

4. **Who does your valuation is important –** There are lots of valuators out there that know how to apply standard theories of valuation to various businesses. On the other hand there are very few that I have run into that have developed expertise in specific industries. The recurring monthly revenue in the security industry requires special knowledge and experience to know how to value. If I were an owner I would ask that valuator if he or she has any valuation experience in the industry that your business is in and secondly to give you market comparables- actual sales of companies like yours.

5. **Recurring monthly revenue (RMR) is a big part of the security industry and has unique value**-The biggest mistake that Certified Business Valuators make in the security industry is to undervalue any RMR in the business. They value it like installation and service revenue. Sadly years ago I watched a 49% owner of a security business in Canada get substantially short- changed on his 49% interest because the company was valued by a well know national firm who was also a Chartered Business Valuator who had no clue about the special value of RMR.

6. **Stand-alone versus Strategic Value –** There can be a big difference between a company being valued on a "stand-alone" versus "strategic" basis. Financial buyers or one partner buying out another often value business on a "stand-alone" basis. Here the buyer assumes that the cost structure of the business will not change much after they buy. There are not likely many synergies. Industry players looking at a business in their same industry are often "strategic" buyers in that they can often "roll-up" an acquisition into their existing platform getting cost reductions along the way. For this reason strategic buyers will often pay more than financial buyers. Most of the alarm account sales that have taken place in Canada over the last 20 years by bigger players have in fact been strategic buys. The buyer can "roll-up" the target block of accounts with little or no extra cost. That is why they will pay up to 36-40X RMR in doing so.

7. **Most security companies are valued using a "multiple of average normalized earnings or EBITDA" –** This rule of thumb applies *to integration, fire and guard businesses*. We will address alarm businesses below. Valuators should use at least 3 years of financials to get at the Earnings before taxes (EBT) over those 3 years. If the security business has significant interest or depreciation expense, each should be added back to the EBT to get to EDITDA. Then each year's earnings should be "normalized"for any non-recurring, unusual revenue or expense items. What is called "Owners Take" is usually one normalizing item. Having done all this then an average of normalized EBITDA is calculated. Finally the valuators must arrive at a plausible multiple to use to be applied against earnings. Multiples for most small security companies are anywhere from 3-5 X Earnings or EBITDA.

8. **Most of the time you value alarm companies differently** – A follow up to point 4 above about the unique value of RMR is that alarm companies with significant RMR are often valued using a multiple of the RMR rather than a multiple of earnings. Using a multiple of RMR often gets the owner of an alarm much more money for his accounts than if you were try to value the company using a multiple of earnings.

9. **Don't forget to value your Balance Sheet –** Most of the value being talked about in the points above is centered on the revenue or income statement of the business. But sometimes the balance sheet also holds value. When buying a complete business, whether it be an asset or share deal, the buyer usually expects to get the fixed assets (vehicles, computers) included in the price they are offering. However this would not generally apply to the real estate or any assets *not required to run the business*. Nor does the price offered apply to any *excess working capital* that might be in the business at closing. Working capital is defined here as Total Current Assets (Cash, A/R and Inventory) less Total Current Liabilities (Bank debt, A/P and Accrued Liabilities) Buyers will want a "normal "or "reasonable" amount of working capital but many of the deals I have help close have coughed extra purchase price to the Sellers because the company had excess working capital in it at closing.

Valuing businesses is both a science in that it requires you know the theory of valuation and an art in that it helps greatly to know the industry that you are working in.

Victor Harding

HARDING
SECURITY SERVICES INC.
UNLOCKING **OPPORTUNITIES** IN THE SECURITY INDUSTRY

Harding Security Services Inc
victor@hardingsecurity.ca