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How the deal market for alarm accounts developed and changed over the years!

I did my first purchase of alarm accounts in 1996 while working for Alliance Security - a franchise network my partner and I had bought 2 years before. The deal involved about 150 accounts bought from an Alliance dealer in London On. The deal was virtually forced on us because that dealer and others were falling behind in their wholesale monitoring payments to us. This was primarily because the pricing for alarm systems had dropped so significantly over the preceding 12-18 months. Dealers for the first time we're offering a basic system for next to free in exchange for a 3-year monitoring contract. What amazed me was how quickly this new low-down pricing affected a typical dealer's cash flow. It only took about 6 months of lower-priced sales, and the dealer was already behind in their monitoring bills.

Elsewhere, by 1996, larger Canadian alarm companies had already started to buy alarm accounts in bulk quickly recognizing the hidden value that alarm monitoring had- i.e., high margin recurring revenue that had a potential life span on average of 8 to 10 years. If you put that recurring revenue (RMR) into a Return-on-Investment template, it quickly became obvious a buyer could pay anywhere from 24 to 36 months of RMR and still make a decent return. This was the basis of the M & A market for alarm accounts. American private equity got into the act quickly and bought into a couple of the Canadian larger alarm companies like VOXCOM and Protectron primarily to help these companies grow their account base.

1996 was also about the time that authorized dealer programs sprung up first in the US based on the same principle as bulk acquisitions. Pay a dealer a multiple of monitoring revenue of anywhere from 26 to 34 months in exchange for a new 3-year monitoring contract. Soon there were several high-volume, marketing companies selling & installing 100 new systems per month in exchange for large amounts of money paid to them monthly.

Just to show you how things have changed, when we did that first purchase of alarm accounts, we didn't use a Letter of Intent to set the terms of the deal in advance. We did little or no due diligence on the accounts to check the installs or paying records of the customers. We didn't deduct monthly cell costs or deferred revenue on the deal, and I am not sure we even had a holdback- all of this mostly out of ignorance on my part and partly because the processes for buying accounts that are in place today were not all in place back in 1996.

As can often happen when growth is emphasized over profitability in any industry, some of the bigger buyers of alarm accounts started to pay too much and at the same spent too little time on managing their attrition. Multiples in the late '90s went up to the high 30s. Attrition climbed to 10% and above. As a result, a couple of these larger companies went through financial reckonings.

But despite some setbacks, the bulk buying and dealer programs have carried on since then primarily because there were dozens of alarm companies out there as potential targets, and if done prudently the

buying made financial sense. And if you were an owner being offered $800,000 for your 1000 alarm accounts, it was too tempting an offer to ignore. The entry of Telus into the Canadian market just 3 years ago and their aggressive approach towards acquisitions suggest that there are still financial rewards to investing in the RMR of alarm accounts although it is likely that the opportunity to get that new alarm customer with Telus was tied to the possibility on taking on TELUS's internet or cell services after.

How have things on alarm account deals changed over the last 10 years? Truthfully more has stayed the same than has changed. Most deals now deduct the fixed-line costs of cell or alarm.com from the gross RMR before calculating the purchase price. Most deals take some kind of deduction for deferred revenue. And finally, most deals take a 10-15% holdback for attrition.

Allow me to comment on a couple of other practices that have developed in the last few years or so that are not so good in my opinion. I think it unfair that so few of the bigger buyers today will buy the shares of the alarm companies. This was not the case 20 years ago. Both VOXCOM and Protectron used to buy shares of larger companies. The difference in take-home pay between a share and asset deal for a seller today in Canada is enormous- well over 30%- and for alarm account buyers to deny an owner the opportunity to use their one-time capital gains allowance is grossly unfair. Take a small holdback to cover undisclosed liabilities if you must and lower your multiple offered a little to reflect the fact that you cannot write off the purchase price- but do the share deal. In the fire, guard, and integration sides of the industry share deals are done all the time.

Secondly for what it is worth I don't completely buy the US fixation about the need to have every single account contracted before an alarm account deal is done. For many years Canadian companies like VOXCOM, Protectron, ADT, and Microtec in Canada bought account bases where some or even many of the accounts were not contracted and nothing bad happened after. Buyers simply contracted the accounts after.

Finally, although I think billing most of your accounts annually on an invoice (as opposed to using monthly PAP from a bank account or credit card) is antiquated, I don't agree with buyers taking a full, whopping big deduction for deferred revenue on their deals. Despite what some buyers use as their justification for this practice, I think it is frankly just a way to dramatically lower the overall purchase price. It certainly does not cost the buyer anything close to what they deduct in the purchase price to manage the accounts until they can be billed.

Just like SPT News, the alarm account acquisition market has survived quite nicely over the last 25 years, and I don't see either disappearing anytime soon.

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