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UNLOCKING **OPPORTUNITIES** IN THE SECURITY INDUSTRY

Tips to keep in mind when Valuing your Business

There are endless amounts you can write about on the ins and outs of business valuations. Below are some of the things I have learned about valuing security companies over the last 10 years.

1. Valuations change over time- Many people don't realize that valuations change over time. This may not seem to be the case with alarm companies where the account base does not change that much over time. But the market may think differently about the same block of accounts from one year to the next. For example, the value of some residential alarm accounts in Canada and the US has dropped recently because of higher than expected attrition experienced by accumulators. So don't assume that because your account base has not changed that the value of it has stayed the same.

2. 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 on the market. And don't delude yourself into thinking you already know what your business is worth. My experience is that most owners of small businesses don't know what their business is worth or think their business is worth more than it really is. I will not embark on a sale process without giving my client a ballpark estimate of what the business is worth.

3. Valuations versus final sale price- A valuation is more of a theoretical calculation of the Fair Market Value of your company. The problem is buyers don't always know everything a valuator knows and many times act irrationally. So in the end the final sales price might well be different from the valuation.

4. Who does your valuation is important – There are lots of valuators out there (Chartered Business Valuators) who know how to apply the standard methods of valuation to various businesses. However, there are very few who have developed expertise in specific industries. The recurring monthly revenue (RMR) in the security industry requires special knowledge 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.

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

6. Stand-alone versus Strategic Value – This is an important concept to grasp. There can be a big difference between a company being valued on a "stand-alone" versus a "strategic" basis. Financial buyers like private equity or a partner buying out another generally value businesses on a "stand-alone" basis. Here the buyer assumes that the cost structure of the business will not change much after they buy. Industry players looking at a business to buy are likely "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 mostly why they will pay up to 36-40X RMR in doing the deals.

7. Most security companies are valued using a "multiple of average normalized earnings or EBITDA" (Earnings before Interest Taxes Depreciation and Amortization) – This method is generally used with integration, fire, and guard businesses but not what I call alarm companies. What is involved here is "normalizing" earnings for any unusual items and applying a multiple to the normalized EBITDA. Most small companies trade at 3-4 X normalized EBITDA.

8. But the market values 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 trying to value the company using a multiple of earnings. The multiples represent the number of months of RMR the buyer is prepared to pay. These multiples can vary from 24 to 40 months of RMR.

9. The Balance Sheet can also have value – Most of the value being talked about in the points above is centered on the revenue /expense side of the business. But sometimes the balance sheet also holds value. When buying a complete business, the buyer usually expects to get the fixed assets (vehicles, computers) that generated the revenue in the first place included in the price they are offering. The price offered also applies to Working Capital where the buyer expects to get a reasonable amount included in the price. Many of the deals I have helped close have coughed extra purchase prices 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 to know the theory of valuation and an art in that it helps greatly to know the industry that you are working in.

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