

What does 2021 look like for M & A and Valuations?

All of us in the security industry should count our blessings that it is the security industry we are in and not some other industry. Not only is our industry generally less vulnerable to yearly, economic ups and downs but on the whole, we seem to have weathered the virus and the accompanying shut-down better than most.

Mind you if you have been reading some of the security magazines you would think that the virus shut-down did not happen or that the security industry loves shut-downs. Frankly, I have trouble believing some of what I have read about activity in the security industry. It all sounded too good to be true. There are not many security companies that I have talked to that were not adversely affected by the virus in some way.

In Canada, there is no question most security businesses were hurt by the virus shut down in some way whether it be an alarm, integration, and fire or guard company. Alarm and guard companies seem to have come through the virus better than the rest perhaps for different reasons

M & A transactions were no doubt down overall in the security industry in 2020 - very slow in March to June period but picking up from July through to the end of the year. I heard of very few integration and fire companies changing hands during 2020. Some owners have been reluctant to put their company up for sale because they fear getting lowballed on price - a perfectly natural reaction. Interestingly enough, the alarm account market for M & A has been very active right throughout the pandemic and alarm account valuations have held.

So what can we expect from 2021 in terms of M & A and valuations in general? Here are some predictions:

M & A will come bouncing back- There has to be pent-up demand for M & A in most industries. The owners who are Baby Boomers aren't getting any younger. Those owners who were worried about selling in 2020 will likely be more inclined to do so in the 2nd and 3rd quarters of 2021. I have potential clients who have told me they are waiting until the virus is past-us before selling. Everything you read says there is a great deal of private equity money on the sidelines looking to be invested. By the end of 2021 M & A could be very busy. If it is a seller's market right now, in 9 months' time the pendulum will swing back to buyers.

Acquisitions will be justified because organic growth is so tough to do – The shut-downs have made organic growth tough in various parts of the security industry. It is still very difficult to get into homes at all. Businesses that have been hit hard by the virus are not likely to pick 2021 to do a major security upgrade. Acquisitions in these situations can very well be replacing organic growth.

Sellers will have to illustrate the effect of the virus to buyers – If an owner wants to sell in 2021, they will need to show the buyer exactly what that effect the virus has had and normalize their earnings accordingly. I am selling an alarm company right now that had higher attrition than normal during the period from April to Aug 2020 strictly to the virus. We had to show the buyer that attrition since Oct 2020 had stabilized. Buyers look at the past but buy the future so sellers are going to have to “normalize” their 2020 earnings to show the effect of the virus and take even greater care in preparing their forecasts for buyers to review.

M & A in general is going Digital - ZOOM will replace on-site visits in deals even after the virus leaves us - and why not! Zoom saves us all an enormous amount of time and money! More and more, entire deals are getting done without the buyer actually meeting the seller in person. I am in the midst of a deal now for a monitoring station that will get done soon but probably would not have if there was not a great deal of trust between buyer and seller.

As a Seller just how digital are you - Buyers will be more interested in companies that have at least a portion of their business done digitally. If a security company can't sell online as well as in person, it will be at a disadvantage.

Some buyers & banks will remain cautious - Economic slow-downs like what we have seen will make some buyers more cautious. Getting financing in place to close a deal will drag out the time it takes to close. Setting up financing may be more difficult and time-consuming through 2021.

Deal terms will Change - Valuations may hold but regarding payment terms, we have already seen longer pay-outs, larger holdbacks and more earn-outs. I have seen the holdbacks on alarm accounts deal rise from 10 to 20%. One buyer told me he actually dropped the multiple on his recent offer because he was worried about the 3rd wave! The virus made revenue forecasts much more important.

There will be an emphasis on quality – Good companies can sell at almost any time. This general rule will be even more critical in 2021. Those deals with “hair” on them are going to be more challenging to do. You don't want to put a company on the market now with problems.

The Baby-Boom Exit is speeding up – The Boomer generation, born between 1946 and 1964 is a large bubble in Canadian demographics. I am a boomer. Someone born in 1955 is now 65 years old. If they own a security business they will soon be talking about an exit. I truly believe that we will be experiencing a higher # of owners wanting to exit their security businesses over the next 5 years. 3 of the deals I am working on right now are happening because the owners are in their 60's or 70's and want to retire.

Government stimulus, low-interest rates and a buoyant stock market will all help make deals happen - Both our federal and provincial gov'ts are dumping vast amounts of money (in fact too much but that is the subject for another article!) into the economy, Some of this stimulus in form of wage supplements and loans will allow deals to happen but will at the same time must be factored out arriving at a price. Secondly, the

central banks everywhere have promised that our ultra-low interest rates will be with us for at least the next 2 years. Who would not want to borrow in these times? Finally, our buoyant stock market propels people to spend and helps in those deals where equity is part of the purchase price.

All in all 2021 should be a very active year for M & A in the security industry with the 2nd half of the year probably being better than the first half.

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