Robert H. Perry & Associates, Incorporated

Notebook of Ideas for Divestitures of Security Guard Companies

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Selling Part Of The Company — A Way To Weather Today's Financial Storm

This article is an update of a similar article we published over 12 years ago when the economy was making a "mild correction". Companies then were looking to sell unproductive assets to combat the down economy, although not so severely felt by the security guard industry.

Our situation today, what many are calling an "economic tsunami," is a lot more severe. Companies from all sectors are making difficult decisions necessary to weather the financial storm, making the advantages of the partial divestiture even more compelling. Large and small companies are considering selling part of the company as a way to raise cash in case the banks decide to limit or not renew the credit lines and the customers slow down on paying their invoices.

The part of the company these owners are selling are divisions or subsidiaries that no longer fit the core operations. The benefits to the seller can be dramatic: making cash available to pay down debt, getting rid of an unprofitable business unit, or in the case of a small closely-held company, offering the opportunity for the owner to slow down, but not get out of business entirely.

Even in a robust, healthy economy the public companies have for many years looked to selling off divisions or subsidiaries as a way to enhance shareholder confidence. Consider these few examples of how a divestiture helped the executives of these public companies in fulfilling their fiduciary responsibilities to the thousands of owners:

- In 2002, SPX, a $4 Billion NYSE company decided to get into the guarding business through the acquisition of Vance International, Inc. — a well respected privately held security guard business with annual billings of around $80 million. It was never really clear to the public as to why SPX, primarily an industrial based conglomerate, decided to get into the service business by buying Vance, but after owning Vance for just three years, SPX sold it to Garda Global, a Montreal-based Canadian public company. Apparently, SPX just never got excited about the guarding business because it was too far afield from its core business. An SPX spokesperson said at the time of the sale to Garda Global that "[Vance] would be a good opportunity for them [Garda]. Vance is now going to be with an owner that wants to grow that business."

- In 2005, Group 4 Securicor, plc announced that it was selling its Cognisa security guard subsidiary to US Security Associates (a privately held company that, in 2005, had over $500 million in revenue). Cognisa had revenues of around $100 million and represented less that 5% of G4S's total revenue in the U.S. In selling off the Cognisa business, G4S made a statement that this part was no longer compatible with the G4S mainline business.

- In 2006, Douglas Flynn, the CEO of Rentokil, plc (a $4 Billion London-based public company), made the announcement that "Rentokil was exploring the possibility of disposing of the group's manned guarding operations to other parties whose strategic focus and/or investment priorities will mean they are more able to realize the full potential of this business." During the year before the divestitures, the manned guarding business (called Initial Security worldwide) had revenues of around $700 million and operating profit of around 4% (before amortization of customer lists and exceptional items). Rentokil would go on to divest the manned guarding business, which included operations throughout Europe, Canada and the U.S., in four separate sales. After the divestment, Mr. Flynn announced that "Completion of the manned guarding disposal process is a further important step in the development of our company. We have achieved a good result for our shareholders and will continue to focus our activities on enhancing shareholder value."

- In 2008, FirstService Corporation, a Toronto-based company trading on the NASDAQ, sold its security guard and security systems integration business to ADT — a unit of Tyco International (NYSE). At the time of the sale, FirstService had total revenues exceeding $1.5 Billion and the guard and systems integration unit that was sold had revenues of around $200 million. Jay Hennick, the CEO of FirstService, in announcing the sale, said" FirstService will utilize the proceeds, together with existing funds and available capital, to drive global growth in its three core service platforms — commercial real estate, residential property management and property improvement service."

- Our firm managed the sale of several transactions over the years for public companies in selling off insignificant security guard divisions — to name just a few: ADT in selling off all its guarding business in the US (acquired as part of a series of alarm company acquisitions) — FirstService in selling off all its US guarding business for its subsidiary, Intercon Security — the Hawley Group in selling off its US guarding business — Tri-S Security in selling off its commercial guarding business...etc.

These public company sellers divested the businesses because it no longer fit the long-range plans or was the most logical source of quick cash. In most instances, the business, although large as security guard companies go, was actually a rather insignificant part of the seller's total volume. The seller's main line of business was usually not security and the remaining business was unaffected by the sell-off. The cash the seller received for the business was put to better use in other areas.

The business that was sold was usually only marginally profitable or maybe losing money under ownership of the seller. The price the buyer would pay was several million dollars and represented, in some cases, well over 20 times what the seller was earning; which made the decision to sell easy.

The decision to sell was made by the Board of Directors, whose mission was one thing — enhance the shareholder value. If it meant down-sizing the company in order to accomplish this goal, then they will downsize.

Partial Divestitures Can Also Benefit Smaller Closely-Held Companies, But Are Often Overlooked As A Viable Plan By The Entrepreneural Owners

For the owners of the smaller company, the decision to sell, or not to sell, part of the company is often driven by emotion, rather than economic prudence. Smaller companies are owned by entrepreneurs who make all the decisions for their company and tend to measure their success in terms of gross volume. The entrepreneur is infatuated with bigness. Making the company smaller is usually not an option. Instead of selling unprofitable divisions, the owner keeps trying to fix them by infusing borrowed funds. This is expensive and has to be paid back. Such a rigid fixation on size often leads to financial problems for the entire company.

But there have been some owners of closely-held companies that realized the importance of selling off part of the company when the timing was right. They proved that the advantages found in the partial divestiture were not a secret lost in the large conglomerates. They were able to recognize the value in selling off part of the company — whether it was a need to come up with quick cash, divest an unprofitable division, or just sell a majority of the company and keep the less stressful part to supplement income during retirement.

In preparing for this article, we reviewed the 150 plus security guard industry transactions our firm has managed. We have represented sellers of companies with annual sales as small as $1 million, as well as multi-billion dollar public conglomerates in selling off security guard divisions. Many of our seller/clients had multiple offices or divisions, which allowed for selling off part of the company without taking value away from the business that remained.

We were reminded from our review that over 100 of these 150 plus transactions had something to do with a partial divestiture; even though some of our seller/clients were small. Here are some of our large and small seller/clients who have sold parts of their company. Since no public announcements for these partial divestitures were made, we will not disclose the identity of the parties:

- A Midwestern-based security guard company sold all its commercial accounts and kept its more profitable strike business.
- An international janitorial company sold all of its U.S. security guard offices.
- A California-based company sold all of its standing guard accounts and kept its roving vehicle patrol accounts.
- An East Coast company sold its guard accounts and kept its investigative business.
- A European-based temporary help company sold its guard accounts in the U.S.
- A New England-based security guard company sold its Florida accounts.
- A Midwestern-based security guard company sold all of its commercial accounts; then offered a specialization in just the Federal government security sector.
- A northeast company sold its guard and janitorial divisions (in separate transactions) and redirected the proceeds into the remaining central station alarm business. After the divestiture, it became a dominant electronic security company in the northeast.
- A Midwest-based company sold off all its accounts in distant states. The volume of the accounts sold represented over $40 million of the seller's then total revenue of around $70 million. The seller used some of the proceeds from the sale to reward the loyal shareholders; and used the rest to pay down debt and expand the account base within the existing operating territory. Today, the company has built back to a volume in excess of the $70 million.

Again, many of these companies had annual revenues less than $20 million when it sold off part of the company. But size is not the key to a successful partial divestiture. Whether a partial divestiture is successful depends on what the seller does with the proceeds from the sale.

A Company Must Have A Divisible Unit In Order For The Partial Divestiture To Work...

Obviously, in order for a partial divestiture to be successful there has to be a generous buyer interested in the division or subsidiary. As we've mentioned in past issues of "Divestitures", the interest a seller gets in the sale depends on the characteristics of the accounts being sold.

If a generous buyer does exist, and today's market is still very favorable for sellers in the security guard sector in spite of the "down economy", the company then determines if there is a divisible unit; that is, a group of assets that can be divested without adversely effecting the remaining business. A divisible unit can be:

- All of the accounts in a geographic area.
- Certain types of accounts — as in the case of the Midwestern company who sold all their commercial customers and kept their strike business.
- A division — as in the case of the California company that sold its guard division and kept the patrol division; or the company that kept its investigative division and sold its guard division.

The Partial Divestiture Results In A More Focused And More Profitable Company...

There is no company too large and few companies are too small to take advantage of a partial divestiture. The only requirement is that the company has "divisible units." The partial divestiture provides needed capital in the form of equity, as opposed to loans that are expensive and have to be paid back...and helps the company reach their financial goals — first by downsizing through getting rid of unwanted separate units — then taking the proceeds and redirecting them into more profitable areas. With today's economic challenges, having sufficient cash on hand certainly helps the company weather the economic storm.

After downsizing through selling off part of the company, the resulting company is usually built back to one larger than its original size — more focused and more profitable.

Written by: **Bob Perry**

Is Your Business Plan Current?

Many guard companies today are looking to change lending institutions, or have an alternative in place; and the first thing the loan officer asks for is a current business plan. If you need to update your plan, call us to find out how we can help with the critical provisions such as valuations, overall market predictions, etc. Our experience and expertise in the security guard industry uniquely qualifies us to add credibility to your business plan.

This periodic informational letter is published by:

ROBERT H. PERRY & Associates, Incorporated

We initiate and manage transactions for sellers of security guard companies. Established in 1977, we have successfully represented over 150 sellers located in the United States, Canada, Western Europe, South America, the Caribbean, and the Middle East.

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