Decoding the Value in Your Security Business – Part 1

Editor's Note: The following article by Kelly Bond is the first of a two-part article, exploring true valuation from RMR (Part 1) and EBIDTA (Part 2 – September) business models

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The IRS loosely defines fair market value as the price at which a business would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell; both parties having reasonable knowledge of relevant facts.

That is a clarifying statement and is purportedly what occurs in every transaction. It also supports the theory that your business is worth what someone is willing to pay for it. But what is that number? How do you know what price to expect when you are ready to sell? Most security companies are valued either on their Recurring Monthly Revenue "RMR" or their Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA). In the security industry, this is often the difference in the value of an alarm company or an integration company.

Let's begin this two-part article by discussing the value of RMR built businesses.

Generally, the sales multiple of most RMR companies is in the 30X – 40X range with most transactions landing at a multiple of 32X-36X. Those multiples have stayed relatively consistent for many years, however, not all companies with the same amount of RMR look alike. Most companies that are focused on RMR ensure there is a contract in place that identifies what services are offered/included and what the end user, be it commercial or residential, is paying for the service. As I have discussed in other articles, there are specific items, terms and conditions that should be included in all contracts, but let's assume all of those are in place.

Not all elements of RMR hold the same value. Certain buyers may pay the same multiple for alarm and fire monitoring, cloud access control and remote video, etc., but may deduct the multiple for maintenance plans or managed services, etc. Due diligence, which a buyer will complete during the sales process, will identify the profit margins of each type of RMR and will lead a buyer to price them accordingly. Buyers often comprise a "blended multiple" which includes the overall purchase multiple they are willing to pay for all the RMR.

Although the sales price for a company may be based on the total RMR, there are several important factors which impact the value of a RMR business:

Where are the accounts located? Buyers seek different traits in a business. Some buyers (very few) are looking for accounts over a national footprint. Most buyers would prefer to see accounts located within 50 miles of an office location and in major markets. Businesses located in rural areas or cities with historically low credit may experience a longer sales cycle as the pool of buyers is smaller.

Do the top 10% of the customers generate the majority of the RMR? Business owners place great value on their top revenue customers but when those customers generate a significant part of the overall revenue, buyers may become skittish when faced with the impact if one of those customers cancels.

Are the margins too high or too low? Some markets across the country have low-cost leaders who prefer a higher volume of customers vs. greater revenue from fewer customers. Adversely, some business owners offer automation or managed services at high monthly rates. While keeping consistently growing margins is important, standing out with monthly fees that are too high or too low can have a significant impact on your value.

Is the company charging for service time and materials? It is not uncommon for businesses to realize that over-time they have been giving away service to many of their seasoned customers. This is problematic when they sell their business as their cost of service is greater than the service revenue generated. This is an easy trap to fall into and can be a red flag when buyers consider what impact billing these customers for future services may have on attrition.

How were the accounts generated? Accounts that were generated by door-knocking efforts, offered as free systems or DIY may turn some buyers away as the stability of these accounts have historically included higher attrition.

What is the gross attrition and what is the leading cause of it? All business owners should be keenly aware of their gross annualized attrition and where it is coming from. High attrition (greater than 11% - industry average) can have a significant financial impact on a transaction.

Does the seller have a contractual commitment to their central station(s)? Breaking a long-term contractual commitment to a central station can result in a costly endeavor if a buyer requires accounts be moved at the closing of a transaction. Consider your exit plan before making a long-term commitment.

Are the accounts on receiver lines that are owned by the company? Ensuring that all accounts are on "clean" lines which are owned by the seller is paramount. If accounts are programmed to shared lines, its likely to eliminate most buyers or at best, a seller will realize a dramatically reduced purchase multiple.

How efficient is the operation? Operational efficiency directly affects profitability and, consequently, business value. Efficient

RMR Part 1, continued on page 28

operations involve effective management, cost control, and technology utilization. Streamlining processes to optimize productivity and implement cost-saving measures can enhance operational efficiency and ultimately a company's value.

Is there clear growth potential? The market position of your security business significantly impacts its value. This includes market share, competitive advantage, and brand reputation. A strong market position often translates to higher valuation due to established customer trust and recognition.

Is there positive cash flow? Cash flow analysis is another critical component of value. Positive cash flow ensures the business can meet its obligations, invest in growth opportunities, and handle economic downturns

What are your all-in creation costs? High creation costs can strain a company's short-term profitability and cash flow, potentially lowering its immediate market value. As with margins, buyers will want to understand the full creation costs for all new accounts.

Decoding the value of your security business involves a thorough understanding of various factors that contribute to its overall worth. This process encompasses financial performance, market position, operational efficiency, and growth potential. By examining these aspects, you can gain a clearer picture of your business's value and identify areas for improvement. If you are unsure of what the value of your business is, reach out to DMAG, we will be happy to review your business with you.

Watch for part-two in the September issue where we will discuss Decoding the Value of EBITDA Businesses.

Kelly Bond brings over twenty-five years of industry experience to her clients. Newly inducted into the Security Sales and Integration Hall of Fame in 2024 at ISC West, she currently serves as Partner with Davis Mergers and Acquisitions Group, representing buyers and sellers of Alarm and Integration companies. .kbond@davismergers.com.