

Q4 2019 Physical Security Industry Update



The Market Continues to Roll Along

Not much need to cite economic statistics as we all continue to enjoy robust market activity levels. I just spoke with an east coast client who said their current backlog is equal to their full year 2019 revenue. The Dodge momentum index did however snap a 4-month string of growth in January 2020 giving some hint of new construction cooling off a bit, but don't plan for it impacting your 2020!

Michael Barnes, at the recent Barnes Buchanan 25th anniversary security conference, reported that total N American residential & commercial market has grown at a 6% CAGR since 2013 and totaled \$64 billion in 2019.

Here are some of the highlights from the conference:

- The \$64 billion market is split evenly, \$32 new system installations & \$32 from monitoring & service revenues. Installation revenues grew 7% in 2019, while monitoring & service growth slowed to 4%.
- The 80 largest commercial integrators reported 21% growth in 2019.
- Alarm dealers selling multi-year, \$40+ month alarm contracts are experiencing accelerating attrition rates, averaging 12% in 2019. As a result, price shifting is happening - lower monitoring revenue / contract confidence is driving dealers to require more upfront payment for alarm systems. DIY behaviors demonstrate a willingness to pay more for the equipment up front.
- A major shift occurred in the capital market. Bank of America & Capital Source, two of the largest lenders into this industry pulled out of the market. **This is a big deal.** Capital supporting M&A will be more scarce. Their pull out is supposedly driven by a couple bad deals rather than a loss of confidence in the industry.
- Verizon, AT&T and Charter/TimeWarner have pulled out the security market after 9 years of investment & effort. Comcast is doing well but saw their 2018 growth of 16% drop to 4% in 2019.
- DIY is here to stay. Barnes believes this market will grow faster than any route to market. 2019 DIY sales grew 24% yet accounted for only 3% of the market.
- The shift in the traditional alarm market, DIY, new entrants, high attrition, and lender exits is changing the way companies are being valued. Pure RMR multiple evaluations are giving way to Steady State Cash Flow based valuations.
- **Local businesses are continuing to be consolidated by regional & national players.** Declining revenue flowing through the independent dealer or contract hardware distributor is demonstrated by growth in the national and regional players. Security revenues from the stand-alone security dealers have dropped from 44% to 38% of total sales. This trend is consistent with the changes in door hardware channel structure.

SDM, January, featured an article by **Karyn Hodgson**, SDM's Managing Editor which focused on the "most influential trends that will shape the security lock & door hardware market". It was great to see an in-depth look at door locking technologies in a security integrator focused publication. This is recognition of the change in product technologies which I believe will drive future channel structures and business models. The article featured the latest products from the leading manufacturers as well as thoughts from many industry leaders. One such is **Bill Smoyer**, National Sales Manager, Access Hardware, who said "Mobile credentials will continue to increase sales, wireless locks will increase in popularity, and smart cylinders will change cost-effective deployment for end users". I encourage every security integrator to read the article.

Life Safety is something we use as taglines, company names and industry descriptors. Unfortunately, door barricade devices are being approved in schools at local levels and are being included in state legislation as an effort to “do something” to increase school safety. As security professionals, we all need to be aware of potential unintended consequences from schools installing devices that violate fire / egress codes, ADA laws, and PASS Guidelines. Organizations such as the National Association of State Fire Marshals, DHI door security + safety professionals, Safe and Sound Schools, NFPA, SIA, BHMA and the Door Security and Safety Foundation have spoken out against these devices. If you encounter these products, please promote the correct application of locking & egress products. For help go to [#lockdontblock](https://www.youtube.com/watch?v=b2M7GrSAGpY), <https://www.youtube.com/watch?v=b2M7GrSAGpY>

Q4 2019 Highlights from the Manufacturers

In last quarter’s update I mentioned that I would stop commenting on Stanley’s Security business because they do not want the business in their group. In their Q4 earnings call, CFO Don Allan made multiple references to “monetizing” the asset to have money to invest in their core business. It will be interesting to see who has the check book to swing this deal; ADT, Universal, Converjint or a new PE entrant?

Allegion: Americas saves the quarter and forecasts a strong 2020. Schlage turns 100 years old.

- Full year revenue was \$2.85 billion. +4.5%, +4.6% organically.
- Q4 total revenue was \$719 million, +2.4% v PY. +3.5% organically. EPS increased 8.7%.
- Adjusted Operating Margin increased 30 bps to 21%.
- Americas sales were \$526 million, +6.8%, v PY all organic. Price contributed 2.2%, electronics were up 12% in the quarter, +10% full year. Residential and non-res grew at the same rate.
- Americas Operating Income was \$153 million. Adjusted ebitda was 30.9%.
- EMEIA revenue was \$150 million, down 5%, -1.5% organic. OM decreased from 19.3% to 16.8%.
- Asia revenue decreased 16.6% due to significant declines in China & Australia. OM dropped from 14.7% to 7.3%.
- Forecasted +3.5 to 4.5% organic growth in 2020 led by the Americas and electronics growth.
- Allegion stock price dropped 3.5% after earnings release, however their stock price increased 51% in 2019.

ASSA ABLOY: Lower organic growth with solid margin & cash flow performance

- Full year sales were 94 MSEK (\$9.4 billion) +12% v 2018; 3% organic, 3% acq, 6% currency. EBITDA +12%, cash flow +27%.
- Q4 total sales were 25 MESK (\$2.7billion) up 8% vs PY. 1% organic, 3% acquisitive, 4% currency. EBIT was up 8%, EPS + 7%. Operating cash flow increased 47%. Strong performance from the Americas & Global Technologies.
- Americas - Organic revenue was up 5%. Reporting has become a bit more cryptic, they did not report total sales change or differentiate between acquisitive and currency impact. Operating margin was 20.0% helped by volume and raw materials tailwind. Commenting - very strong

growth for electromechanical products and perimeter security, strong growth in residential, Canada, security doors and architectural hardware, but a decline in smart residential sales.

- Global Technology (HID & Ving) group was up 2% organically, operating margin was 18.3%. Very strong growth in extended access (whatever that is??).
- Entrance Systems was up 1% organically. Sited growth in residential doors & logistics solutions.
- Asia continues to be a drag. Revenue was down 10%.
- New leadership in place at HID and Entrance Systems.
- New products / initiatives included an August Wi-Fi smart lock, a smart cabinet lock from Yale and a collaboration with Samsung on a UMB lock.
- Completed 3 acquisitions in the quarter 12 during the year.
- CEO Nico Delvaux said that acquisitions will be the main growth driver in 2020
- Stock price is at a 52-week high 2/18/2020. Stock price increased 26% in 2019.

dormakaba: Opened new two new facilities: 200,000 sq ft in Indianapolis & 100,000 in Phoenix

In December I had the opportunity to attend the christening of their new 200,000 sq ft facility in Indianapolis. dormakaba's N American CEO Michael Kincaid, VP Sales Phil Bradney and VP Marketing Joe Hudok hosted a business update for many of their larger distributors and then all employee events to launch the new facility. Meeting highlights included.

- While Americas year over year performance seemed to lag competitors, considering the divestment of a service business, declining sales in Latin America, and maturation of the Lodging lock replacement cycle, their core businesses demonstrated organic growth performance similar to its competitors.
- With the new facility, Indianapolis will become the headquarters for the Americas.
- Mesker was in the process of moving into a new, 3X larger facility in Phoenix.
- Sales & marketing teams are being structured around key vertical end markets.
- Several new products were highlighted; large format LFIC, new continuous hinges, exit devices, site survey apps and SwitchTech, their version of a smart cylinder.
- The dk management team has undertaken an enormous task in setting a new strategy and getting their arms around a very complicated set of businesses. The Dorma Kaba merger was in early stages, they added Mesker / Design Hardware, and then Best and now are getting traction on the entire portfolio. The direction of the leadership was clear and positive. We will see dk continue to grow and improve their position in the market.

M&A Highlights

Convergint made their 5th acquisition of the year with **Pendergraph Systems**, a full-service systems integrator based in Oklahoma.

Allied Universal continued their buying spree adding two manned guarding businesses; **APG Security** in NJ, and **SOS Security Services** a global services provider. Allied now employs over 230,000 security professionals. Allied also acquired **Advent Systems**, #56 on the SDM top 100 list. Advent is a full-service systems integrator based in Elmhurst, IL.

Bates Security acquired **Absolute Protection**, a commercial & residential security integrator based in Vero Beach, FL.

ADT Commercial acquired **Critical Systems**, fire & life safety & security integrator based in Marietta GA,

Cook & Boardman was busy in Q4. The largest commercial door & hardware systems provider in N America added; **ABS** in Chicago, **Builders Hardware** in Erie & Pittsburgh, & Akron's **Botzum** hardware.

Jeff Wyatt and PE backer **Riverside Company** announced the creation of **Certrasite**, a Fire Life Safety integration business headquartered in Indy. Jeff had 30 years of leadership experience at **Koorsen Fire & Security** and has already rolled up 5 companies in the Midwest.

We were proud to have represented Jackson, TN based **Townsend Hardware & Security's** sale to **Progressive Alarm & Technologies**. Townsend was not a strategic part of Martin Inc's portfolio but adds a hybrid door & hardware / security integration business to Progressive.

Our Featured Business Opportunities

- A northeastern full-service security integrator providing access control, VMS, perimeter security, and ID management to fortune 500 clients for the past 40 years. \$9.5 million revenue, \$1.5 million ebitda.
- A northeastern security integrator specializing in financial services & high asset base clients. Management on board for the long term. \$400,000 monthly recurring monitoring & service contracts. \$12 million revenue, \$3 million adjusted ebitda.
- Florida based security services business supporting long standing national accounts. Unique business model with contractual service agreements, monitoring contracts all driven by a customer facing, interactive software platform. \$12 million revenues, \$2.5 million ebitda.

See our complete listing of current business opportunities at <http://www.graybeardsrus.com/>

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