



Q3 2022 Physical Security Industry Update

Manufacturers delivered a strong quarter, led by Allegion's blow out results. Most channel companies have record backlogs, and M&A continues at a frenzied pace.

This will be my last quarterly update....

I have been making this update for 8 years now. Time has flown by, and I intend to spend more of it with my family and hobbies. I am not (completely) retiring and will finish my active transactions and pursue select transactions going forward. This industry has been thoroughly enjoying, has provided a fulfilling career and my family with a good lifestyle. Most of all though, we have made many great friends.

Over my 22-year career in this industry, I have been part of European door & hardware business restructuring, North American sales force restructuring, many acquisitions and divestments, growth in electronic access control and engaged with many great management teams.

During this time, we have seen significant consolidation of manufacturers. At times it seems there are no more consolidation opportunities when Allegion buys Stanley's automatic door business and ASSA attempts to buy HHI. While consolidation of the manufacturers is maturing, consolidation in the channel is shifting into high gear.

For the past 8 years I have tried to stick my nose into as many of the channel businesses, both door & hardware distributors and security integrator transactions as possible. The channel consolidation is accelerating with the security integration channel being further along. The consolidation has been and continues to be driven by three key dynamics. 1. Demographics – baby boomer business owners wishing to retire with no succession plan, 2. Access to cheap money for Private Equity firms & public companies. 3. Overall attractiveness of the security industry. Number 1 & 3 are still good. #2 is changing significantly and may slow down the number of deals and lower prices paid for businesses.

How will the consolidator's business strategy play out in the future?

The consolidator's business strategy:

- Acquire similar channel companies based on valuations of 5X EBITDA
- Build a larger and larger platform of companies with larger EBITDA
- Attempt to mold the disparate companies into a coordinated portfolio
- Sell "flip" the portfolio in 3 - 5 years to another PE firm for 8X the larger EBITDA base
- New PE firm continues consolidating with the intent of flipping in a few years

Since launching 3SE in 2015, I have been involved in roughly 35 transactions. Unfortunately, in more than 30% of these transactions, the surviving company is not a “better” company after being acquired. “Better” meaning larger revenue and EBITDA. Some consolidators rush to combine or roll the acquired company into their model whether it makes sense or not. It is not always a good idea. This discussion is for another time...maybe a book deal?

The consolidation business model has been executed in a growing marketplace. If we have a slowdown in the market, the PE and public companies will not be content with declining profitability and will not be willing to suck it up in tough years like the private owners have in the past.

Q3 2022 Industry Highlights

The DOJ has blocked ASSA ABLOY’s \$4 billion acquisition of HHI. AA wants to do this deal so badly they may sell EMTEK and Smart Residential (Yale residential) which generated \$350 million in revenue in 2021. HHI makes sense as a leap forward in residential products, smart home products and channel penetration, but it will be a challenging structural change. Might look like a great idea in a power point presentation / Excel financial model but be totally different in execution.

Q3 2022 Highlights from the Manufacturers

Allegion: Blow out quarter due to Americas’ performance!!

- Q3 total revenue was \$913 million, +27.4% vs PY, +18.6% organically with 12.6% coming from price realization. Access Technologies (Stanley Automatic Door business) accounted for 12% of the organic growth. Like for like without AT’s \$23.6 million revenue, the business grew 24% vs PY.
- Adjusted EBITDA was up 100 bps from 22.6% to 23.6%. AT was a 100 bps drag to EBITDA. Adjusted EPS as was up 5.1% to \$1.64. M&A and purchase accounting for AT drove reported EPS down \$0.34 to \$1.30.
- Americas’ Q3 sales were up **42.5% to \$747.2 million**. +25.8% organically. AT growth in the mid-teens, Non-residential up 30%, residential up mid-teens, and electronics up 30%
- Americas Q3 Operating Margin was up 50 bps to 26.0% but without 300 bps drag from AT it would have been 28.5%. Indicating that the AT is nicely profitable but demonstrating how challenging it is for Allegion to make an acquisition that is acquisitive to results.
- Allegion International – Q3 sales declined (12.8%) to \$166.5 million. -0.8% organic. +6.9% pricing was completely offset by -12.8% currency headwinds. Adjusted ebitda was down 160 bps to 14.5%.
- 2022 full year Guidance increased organic growth by 0.5%
- Management’s comments – “Outstanding performance, Access Technologies off to a great start, Global supply chain improving, Continued strength in Allegion Americas non-residential end markets and global electronics demand”.

ASSA ABLOY: Very strong sales in the Americas, Entrance Systems and Global Technologies

- Q3 total sales were 31.8 MSEK (\$3.2 billion) up 33% vs PY. +14% organic, +16% currency, +3% acquisitive. EBIT increased 39% while EPS increased +37%. Strong leverage!
- Americas Q3 revenues were up 17% organically. “Strong sales in all regions and all product lines”. Operating margin was 20.9 vs 20.6% PY. Strong price realization. M&A expense for HHI was -110 bps in the quarter.
- EMEA increased 4% organically. Operating margin was 14.3% vs 11.3% PY. Very strong sales in Scandinavia, Eastern Europe, Africa & the Middle East. Sales declined in the UK, France and Benelux.
- Asia continues to struggle, sales declined 2%. Operating margin dropped from 5.8% to 4.5%. Impacted by low volumes and COVID lockdowns in China.
- Global Technology (HID & Ving) group was up 19%, operating margin improved from 15.8% to 17.3% PY. Strong sales in Citizen ID and Physical Access Control products.
- Entrance Systems was up 20%. OM increased from 14.8% to 15.7%. “Very strong sales in residential & industrial markets.
- Completed 6 acquisitions in Q3,11 YTD. Contributing 3,300 MSK in sales. One company was J Newton Enterprises in Inverness, FL. that sells, installs & services pedestrian automatic doors from six locations in FL. It will roll up under Entrance Systems’ division.
- Just announced 11/1/22 the acquisition of Australian based **D&D Technologies**, a global leader in gate hardware and specialty hinge products. D&D had sales of MSK 475 in 2021. I had the opportunity to work with D&D leadership as part of the deal team throughout the process.

dormakaba – Some organic growth, lower EBITDA margins from Mesker & inflation impact

Note these are full year results ending in June 2022

- Total company had full year revenue was CHF 2,756.6 million (\$2.7 billion) vs 2,499 (\$2.5 billion) PY, +10% growth, 7.7% organic. Adjusted EBITDA margin decreased from 14.5% to 13.5%. Negatively impacted by Mesker divestment cost, inflation, war in Ukraine, higher labor cost & unfavorable mix.
- Americas total revenue increased 8.3% organically, driving sales from CHF 672 to 744 million. Benefiting from a recovery in commercial construction market, Latin America, and market share gains. EBITDA margins dropped from 2.8% to 2.3% from inflation and unfavorable mix. Mesker was a -210 bps drag on results. Mesker was divested in June 2022.
- Asia sales increased 11.3% organically. EBITDA was flat at 3.3%. Good sales growth in India, Southeast Asia, and the Middle East.
- Europe & Africa sales increased 5.9% organically. EBITDA was flat at 14%. All markets & product clusters showed growth. Automatic doors & door hardware had double digit growth.
- Key Systems & Moveable Walls division grew 5.7% organically. EBITDA declined 190 bps to 3.8%.

M&A Highlights – The “Consolidators” continue at a frenzied pace

Pye-Barker *probably has not even met some of the companies they have purchased*, adding:

- Jacksonville FL based **Bender & Modlin Fire Sprinkler**
- **Complete Security Systems** in New Jersey
- **Bisco Protective** serving NYC and surrounding vicinities
- Middletown CT based **ISG** who specializes in financial services and government facilities. **Steve Rubin** of **Davis Mergers & Acquisitions** represented **ISG**
- **Industrial Fire & Safety** in Birmingham, AL

MCA acquired Texas based **Knight Security** systems to expand their market with complete coverage of the Texas market. **Dave Sylvester** with **Davis Mergers & Acquisitions** represented Knight in the transaction.

Sciens continues to build out their N American presence with:

- Michigan based **Elite Fire Safety** with 80 employees
- Pennsylvania based **Anchor Fire Protection**
- Lodi California based **CEN-CAL Fire Systems**
- NYC's largest privately owned fire alarm company, **Firecom**

Convergint acquired N California's **Ojo Technologies**, specialist in education & transportation markets.

CertiSite continued its acquisition run adding three new Ohio operations. **Hamrick Fire Systems, Fire Loss Control** serving Cleveland and their 20th acquisition of Cincinnati based **Burnside Fire Protection**.

A new player, **Rapid Fire & Security**, launched a venture platform with the acquisition of **Security & Access Systems** in St Louis. Rapid Fire SS is lead by industry veterans Mike McLeod & Colin Harrold and is backed by PE firm Concentric Partners.

ACRE acquired South Florida based **SISCO**, a leader in visitor management software, general credentialling, and pioneer and leader in cruise ship industry credentialling.

*It's still a **seller's market!!** If an ownership transition is in your 3 – 5-year plan, don't hesitate to reach out to explore your options.*

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