

Contract Security Industry 2020 Year in Review and 2021 Outlook



THE MARKET – 2020 Review and 2021 Outlook

Here's what happened to the market in 2020...

In gathering our information for this report, we interviewed owners of contract security companies mainly throughout the U.S. with revenues between \$10 million and \$400 million. Our main question was: what effect did the pandemic have on revenues for 2020? As expected, we got a wide range of answers that depended on the mix of business and the geographic area being serviced. For the most part, companies with a large percentage of their business coming from aviation, public events, hospitality, rental car agencies, educational institutions and in-store shopping locations reported a decline in revenues from these sectors. These companies, as well as companies that do not have customers in these sectors, reported significant growth in their revenue starting around the first of the third quarter mostly coming from the concerns over the civil and political unrest and the continuing need to provide the high margin COVID work. Some reported getting business from their larger competitors, but this aspect was not as prevalent as in our previous reports.

The 2020 year certainly tested the U.S. manned guarding market that, as in previous years when our country experienced economic challenges, continues to respond with resilience. In spite of starting the year with a dip in revenues, the industry rebounded with continued growth through the end of the 2020 year in a time when most businesses in the U.S. are still experiencing declining revenues and profits. The large companies have not published their year-end reports yet, and we're still talking with owners around the country. It's too early to estimate the size of the total market, but we expect the year 2020 to show at least modest growth.

Outlook for 2021...

When we asked the owners about their projections for 2021, the overwhelming majority had a very optimistic view of the year in terms of revenue growth and the improving economy. But all the owners were concerned about their ability to maintain their bottom line due to: the probable \$15 minimum wage mandate, the increase in the unemployment tax rate due to the large amount of unemployment compensation being paid, and raising taxes on earnings.

The owners thinking about selling their company in the near future were concerned about the proposed 100% increase in taxes on the sale of a business [as an example: assuming the sale multiple stays the same under the new proposed capital gains rate tax, a manned security company has to be approximately 30% larger in revenue in order for the seller to net the same dollars as the seller would have netted if he had sold under the present rate – this caused many owners to accelerate their timeline for selling to get a deal done in 2020]. Some experts are saying that even though the increase in the capital gains rate is all but certain, the probable effective date may still give owners wanting to sell time to get a deal done in 2021 and take advantage of the lower rate.



MERGERS and ACQUISITIONS

2020 turned out to be a very active year for acquisitions...

In spite of the travel restrictions imposed by the pandemic, the buying and selling of manned guarding companies for 2020 continued at a healthy pace. Typically, there are several face-to-face meetings taking place before a sale transaction crosses the finish line, but the selling and buying parties learned quickly in 2020 to adapt to the new way of doing transactions – replacing face-to-face meetings with Zoom and Team video calls and enhancing the use of the virtual data rooms.

In fact the number of deals in the manned guarding space was on track with the number in the past two years - with 26 transactions being reported to us. Allied Universal purchased the largest companies - Summit Security, a \$200 million manned guarding company headquartered in New York City and most recently the [manned guarding division of SecurAmerica representing approximately \\$467 million in revenue](#). In spite of a slow start, the year 2020 turned out to be a banner year for our firm, managing the sale of companies with revenues from \$3 million to over \$200 million; with two transactions closing on New Year's Eve.



[The latest on the Allied Universal/G4S Proposed Transaction...](#)

On December 8, 2020, the boards of directors for Allied Universal Topco LLC (a newly incorporated entity indirectly controlled by Allied Universal) and G4S plc announced that they had reached agreement on the terms of a recommended cash offer for Allied Universal to acquire the entire issued, and to be issued, share capital of G4S. The Allied Universal offer amount is \$5.1 billion representing 245p (British pence) per share. This trumps the 235p offer already on the table from Garda World – approximately \$4.9 billion – which, so far, is the last of several offers presented by Garda World. Allied Universal sent its tender offer to the shareholders on December 10, 2020; with an acceptance date of February 8, 2021. However this bidding war has dramatically increased the price of the G4S shares, now trading at around 255p – significantly higher than the share price in January before the world stocks took a nose dive - indicating that the G4S shareholders may be holding out for a higher bid from Allied Universal, Garda World or another yet to be identified bidder.

If Allied Universal is successful in buying G4S, here is what the combined companies will look like:

- The headcount will be approximately 800,000 employees located in over 85 countries
- The revenues will be coming from:

| | |
|----------------------------|-----|
| Americans (primarily U.S.) | 68% |
| Europe | 21% |
| Asia | 8% |
| Africa | 3% |
- The technology offerings of the combined companies will be approximately 22% of total revenues, being supported primarily by the long term investments of G4S in technology platforms; while Allied Universal has only recently started building and buying companies to enhance its technology offerings.
- The more efficient and expanded footprint resulting from combining the companies will enable Allied Universal to service present customers in areas where the single company did not have a presence. Allied Universal's present revenues, representing almost 50% of the revenues of the two companies combined, comes primarily from U.S. locations. After the sale, Allied Universal will be able to service more foreign locations for these U.S. headquartered conglomerates through the more than 85 country locations presently being serviced by G4S.
- As set forth in the "Publication of Offer Document" issued jointly by the parties, after the sale Allied Universal will maintain a United Kingdom headquarters for all of its international operations outside of North America. Allied Universal Group's current headquarters in Santa Ana, California will serve as the Enlarged Group's headquarters for its operations in North America.



Government Assistance/Legislative Changes

The Federal Government has passed two bills that have helped owners of small companies – called the Payroll Protection Program. Many owners of eligible contract security companies applied for and received the forgivable loan under the first bill (PPP1), but not many owners will be eligible for the latest round of funds (called PPP2) since it's only available for businesses whose revenues have fallen more than 25% for 2020 over the 2019 year . . .

As of the end of 2020, the Federal government had enacted several stimulus programs providing for approximately \$3.5 trillion - to include approximately \$935 billion primarily for the benefit of small to medium - sized businesses. It also has a new bill on the table calling for an additional \$1.9 trillion. This article is not intended to present an exhaustive list of all the programs and the qualifications to receive the monies (the CARES ACT alone covers 880 pages), but is a summary of some of the most popular and important programs available to businesses in need of help. Each has requirements to qualify and the rules keep changing. Therefore, owners wanting to apply for any of the benefits should seek assistance from an expert who is qualified to give such advice.

Basically, three Acts have been passed (including the most recent act passed on December 27, 2020 providing for the Payroll Protection Program #2 – PPP2); each offers assistance to businesses and individuals:

- ***The first Act, called the Families First Coronavirus Response Act (FFCRA)*** was passed on March 18, 2020. It was an expansion of the medical leave provisions and provided for employers, who meet the stringent qualifications, to claim fully refundable payroll tax credits equal to the amounts required to be paid to their employees who have to take time off for COVID-19 related reasons.
- ***The second Act, called the Coronavirus Aid, Relief and Economic Security Act (CARES Act)***, was originally passed on March 27, 2020 and provided for \$2.1 trillion of funding - \$310 billion going to the businesses qualifying for the Payroll Protection Program – now called PPP1 and is explained below. Another round of funding for \$2.4 trillion, with \$310 billion going to the PPP1 was passed on April 24, 2020. The Payroll Protection Program (PPP1) gave businesses with fewer than 500 employees a forgivable loan equal to 2.5 times the average payroll; and forgave the loan if the company maintained a certain number of employees for the 8 weeks after receiving the loan. For example: a qualifying contract security company having \$10 million in revenue and 70% labor to bill ratio would be eligible to receive almost \$1.5 million to be used for payroll and no more than 25% of the amount received going to rent and utilities. A little known provision in the PPP1 also allowed certain qualifying companies with more than 500 employees to receive the funds up to \$10 million. Many contract security companies applied for this loan and so far have achieved success in getting the loan forgiven. There was a period where the expenses paid for by the forgivable loan would not be deductible, making the loan a lot less attractive. But the IRS reversed its position on this in the latest appropriations bill approved on December 27, 2020; so now the IRS allows the expenses paid as a reduction of taxable income.

- **The third Act, called the Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act (the Act)** passed on December 27, 2020 provided for \$950 billion of which approximately \$300 billion goes to support small businesses and will be called PPP2, and \$120 billion going to expanded unemployment compensation. The qualifications to receive forgivable loans under PPP2 are quite different than PPP1 and are mainly available to companies with a decline in revenues – 2020 vs 2019 – of more than 25%. The maximum loan amount available under the PPP2 program is \$2 million (with certain exceptions). Given that the PPP2 is only given to companies with 25% decline in revenues, it's believed that not many manned guarding companies will be eligible this time around given the stable revenues most had for the 2020 year.
- **A fourth Act, calling for \$1.9 trillion, is now being proposed by President Biden**, who hopes to see it passed through Congress in the immediate weeks after taking office. It basically provides for an additional \$1,400 stimulus payment to qualified individuals (on top of the \$600 from the 3rd Act), billions for a national COVID vaccination program and raising the minimum hourly wage to \$15.

The Democratic Platform and How It May Affect the Way Owners of Contract Security Companies Run Their Business

The Democratic Platform, if and when approved, will definitely change the way most individuals and businesses are taxed. However, it's worth noting that often bills that get introduced before Congress get watered down before passage or don't receive the required number of votes. Therefore, some of the proposals listed below may never make it to President Biden's desk for final approval.

President Biden has vowed to not increase taxes on families making less than \$400,000 per year, but those making more than that will likely see increases and the increase may be dramatic. Below are just SOME of the increases applicable to many individuals and businesses:

Proposed changes to individual taxes:

- Impose a 12.4 % Old-Age, Survivors, and Disability Insurance (Social Security) payroll tax on income earned above \$400,000, evenly split between employers and employees. This would create a "donut hole" in the current Social Security payroll tax, where wages between \$137,700, the current wage cap, and \$400,000 are not taxed.
- Revert the top individual income tax rate for taxable incomes above \$400,000 from 37 % under current law to the Pre-Tax Cuts and Jobs Act level of 39.6 %.
- Tax long-term capital gains and qualified dividends at the ordinary income tax rate of 39.6 % on income above \$1 million and eliminate step-up in basis for capital gains taxation.
- Phase out the qualified business income deduction (Section 199A) for filers with taxable income above \$400,000. This mainly applies to owners of Subchapter S corporations, partnerships and LLC's who, under the present tax law, get a 20% deduction on earnings from the pass through profits of their businesses.

Proposed changes to business taxes:

- Increase the corporate income tax rate (on "C" corporations) from 21% to 28%
- Expand the Affordable Care Act's premium credit.

Other proposed changes:

One of the changes the Biden administration is trying to get through immediately is the \$15 per hour minimum wage mandate. In fact, just two days after President Biden was inaugurated, he signed an executive order calling for a \$15 hourly minimum wage for all Federal employees and subcontractors. The \$15 rate has been on the Democratic agenda for several years now, but without control over the Senate, it never got passed. Now

that the Democrats have control over Congress and the White House (albeit only by a very small margin), this is all but certain to get passed very soon. The question on everyone's mind though is the timing for enforcing the minimum wage and whether or not it will be phased in over time or become effective at the full \$15 rate when it gets passed. Another proposed change in the Democratic platform is restoring some, if not all, of the Affordable Care Act provisions that got rolled back under the Trump administration. So far, there's no clear guidance as to the importance of this provision and when it may be introduced.

The Timing:

Typically, even though a political party is in control of Congress and the White House, as the case with the Democrats now, they still can't get legislation passed for several months after it's introduced. In 2001, with the Republicans in control of Congress and the White House, it took them until Memorial Day (or about 4 months) to get the first Bush tax cuts approved, which became retroactively effective at the beginning of the year. When President Trump took office in January of 2017, it took until November of that year for the GOP introduced tax cuts to get approved – which were effective beginning in 2018.

The current thinking is that a significant tax bill would take well into 2021 to complete, with an effective date of the beginning of 2022. But most experts are saying that some of the proposed changes such as the \$15 minimum hourly wage mandate (already included in the proposed fourth Act mentioned above) and increase in capital gains rates may get approved and become effective much sooner than the other proposals. One thing is clear though; with about \$3.5 trillion already being pumped into the economy to help struggling companies resulting from the COVID-19 crisis, and an additional \$2 trillion in the proposal stage, our Federal budget will need help. Raising taxes sooner rather than later may be the only solution.

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List of Resources:

- Allied Universal website
- G4S website
- Dow Jones & Company releases
- Peter G. Peterson Foundation reports
- USA Today
- NY Times
- Washington Business Journal
- The Tax Foundation reports
- Journal of Accountancy

For over 25 years we have successfully completed over 250 sell-side engagements for security companies located in 8 countries and having revenues between \$2M - \$200M.

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