ALARM
CAPITAL
ALLIANCE

Transforming Your Company into a High-Value Business

Executive Summary

Whatever your goal – a complete exit from your company or the sale of some of your accounts to take cash out of your business, obtain capital to achieve your company's growth objectives, or pay down your debt – you want to work with a trusted and experienced buyer, one who will respect the company you've built and recognize the true value of the accounts you created. To attract this kind of buyer, you need to operate your business every day in a way that ensures your accounts are attractive, valuable, and ready to sell when you are.

Here are six ways to do that: plan your growth and ultimate exit strategy and run your business with your end-game in mind; monitor and manage your attrition, keeping it at or below the accepted industry rate; adopt and follow sound standard operating procedures for your subscriber and business records, your central station monitoring, and your billing and collections; make sure all of your accounts have valid subscriber agreements that are assignable and protect both you and any potential buyer; manage installation and monitoring to facilitate the easy transfer of accounts to potential buyers; and mitigate your company's risk with an appropriate insurance program.

Taking just a few of these steps will help increase the value of your company and your accounts. Implementing all of them will help you build a high-value business that potential buyers will want to invest in.

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The Six Keys to Building a High-Value Business

1. Plan your growth and exit strategy
2. Monitor and manage attrition
3. Adopt and follow sound standard operating procedures
4. Make sure your accounts have valid subscriber agreements
5. Manage installation and monitoring to facilitate account transfer
6. Mitigate risk with the right type and amount of insurance

Envision Your Goals; Maximize Your Value

What are your goals for the future, both for you and your company? Do you want to exit completely by selling your company and enjoying the equity you've worked hard to build? Maybe you'd like to sell some or all of your alarm accounts to support taking your business in a new direction or starting a new venture. Or maybe you envision growing your company, staying involved and in control, by bringing in a solid business partner to power your sales and operations.

Operating your business in a way to maximize the value of your accounts is the key to achieving all of these goals, no matter what your timeline. When you start thinking about your options – which you should do long before you want to take action – it's critical to work with a trusted and experienced buyer. The right buyer will not only value your accounts and business fairly, but will recognize your unique situation and give you confidence it will support the business you've built by following through on your company's commitment to integrity, superior service, and customer focus.

Attracting this kind of industry-leading buyer requires planning. Don't wait until you've decided to sell to get your company and your accounts in top shape!

Plan Your Growth and Exit Strategy

Companies who consistently run their business according to a strategic end-game plan ultimately attain the most value for their accounts.

While there is no one "right" growth and ultimate exit strategy and no one "right" way to develop that strategy, you should establish and pursue a definite plan, and use it to drive your daily operations.

Your strategy should include a few key elements:

- Short and long-term goals, business and personal
- Steps to reach those goals
- Challenges you anticipate along the way
- Tentative timeframe

Your goals might change over time, and you will want to review and re-evaluate your strategy periodically. Once you have your plan, however, it's critical you stick with it, using it to guide everything your company does, from management decisions and standard operating procedures, to your central station and vendor relationships, even your day-to-day operations.

Monitor and Manage Attrition

In the electronic security industry, acquisition value is most often measured as a multiple of recurring monthly revenue (RMR) from "qualified" accounts. Attrition is a key value driver – or detractor – that directly impacts how much potential buyers are willing to pay for your accounts. A high-value company will take consistent steps to maintain attrition rates at or below industry standards (about 12 percent gross attrition).

Gross attrition is simply defined as the total number of subscriber accounts your company loses over a period of time, typically measured in losses over the trailing year, divided by the average number of accounts your company owned over the same period. An accurate attrition calculation also reflects account aging. Any account more than 90 days past due is, by industry standards, canceled, regardless of whether the subscriber has given notice. Ordinary attrition results from issues outside of your company's control: customer moves, deaths, financial issues such as job loss or bankruptcy, and other customer life issues affecting demand for alarm services. Extraordinary attrition occurs either when customers cancel accounts for reasons related to your company's performance, or when a competitor is able to win over your accounts with its marketing promotions or sales strategies.

An accurate attrition rate provides a buyer with both significant comfort in your record keeping and a general picture of the economic health of your company. Apart from attracting potential buyers, monitoring attrition on a regular basis also helps your company identify and react to problems; both internal factors such as customer service issues and external factors such as competition or economic conditions. Armed with accurate information about attrition, you can develop procedures to minimize account aging and loss.

Attrition is a key metric that directly impacts how much potential buyers are willing to pay for your accounts.

$$\frac{\text{Accounts lost over the past year + accounts over 90 days past due}}{\text{Average number of accounts owned over the last 12 months}} = \text{GROSS ATTRITION RATE}$$

A simple example of this calculation would be:

$$\frac{\text{90 accounts canceled + 10 accounts more than 90 days past due}}{\text{1000 accounts average over the last 12 months}} = \text{10\% ATTRITION RATE}$$

Adopt - and Follow - Sound Standard Operating Procedures

One way to minimize attrition and maximize revenue is to develop and implement solid standard operating procedures. Sound standard operating procedures help your company provide excellent customer service for your subscribers, which can lower attrition rates and increase revenue. They help you run your business in an efficient and cost-effective way, and companies with good standard operating procedures, generally, receive more for their accounts. When it comes time to sell your accounts, having good standard operating procedures in place allows you to provide crucial information to your potential buyer.

Your company's standard operating procedures should include:

- Maintaining accurate subscriber and business records
- Reconciling accounts with your central station on a monthly basis
- Adopting and following sound billing and collections practices

Your business and account records help establish the value of your accounts to potential buyers during the due diligence stage. By regularly and accurately tracking account and operations data, you can take a snapshot of your company at any time. This not only allows you to provide crucial information to potential buyers, but also is key to the on-going management of your company.

Ideally, your company should employ a standardized process that will help track billing data, as well as service and installation information. Using software that automates many of the standard record-keeping functions has the added advantage of allowing your team to generate the kinds of financial reports valued by potential buyers. In addition, conducting regular audits, monitoring payment, collection, aging trends, and tracking account cancellations with codes identifying the cause of the cancellations, can all help reduce account loss and increase revenue.

Your company should also make a regular, scheduled monthly reconciliation of accounts with your central station to ensure any subscriber accounts canceled within the past month in your billing system are also properly canceled at the central station. This reconciliation helps reduce monitoring costs and gives you another opportunity to detect and react to any causes of extraordinary attrition.

Potential buyers may also require add/delete (online/offline) and other customer account reports from your central station. Many potential buyers view this information as critical to the acquisition process, and it's important to know what services and capabilities your central station agreement provides.

Clear and appropriate billing practices are another critical element of your standard operating procedures. The key to this aspect of account management is to have an established billing process that fits your company's needs for cash flow, minimizes time and expense related to billing, and reduces the potential for past due accounts and the need to put those accounts into collections or cancel them.

While many companies bill their subscribers annually, to minimize the time and cost of billing and ensure full payment for a year's service, annual billing can cause cash-flow problems and make it difficult to establish consistent subscriber payment histories. Monthly or quarterly billing practices give your company a more even cash flow and allow you to show consistent payment histories for your accounts. Furthermore, billing subscribers less frequently than monthly may result in a "deferred revenue" deduction from the purchase price. For example, if you bill quarterly on January 1, and you sell your accounts on March 1, you've already billed and possibly collected revenue through March 31. The buyer would be entitled to a deferred-revenue deduction for the amount billed for March's service period, in other words, one month of RMR.

Good collections procedures, which should be explained clearly in your subscriber agreement, are also critical for maximizing your company's revenue and the value of your accounts. Your company should have a standard collections procedure in place for delinquent accounts and should begin using it early in the billing cycle, when accounts first become past due, to minimize aged receivables and attrition. The process should end with sending a cancellation notice, once an account has exceeded 90 days past due, giving the subscriber the final opportunity to pay the past-due amounts within a short, but reasonable, period of time.

Your billing and collections practices can directly affect the amount of cash you receive for your accounts.

Using an automated payment process, ACH or credit card, can reduce the expense of billing and regulate cash flow, which gives you the ability to demonstrate subscriber payment histories. However, automated payments may present challenges when it's time to transfer subscriber accounts. For example, PCI DSS (Payment Card Industry Data Security Standards) compliance rules require that PCI-compliant companies provide consumer data only to another PCI-compliant company. Many processors are hesitant to release this data, leaving companies scrambling to collect it. To avoid this scenario, consider entering into an agreement with your automated payment processor before starting the service, which allows you to release customer data to another PCI-compliant company in the event of a sale.

Make Sure All Your Accounts Have Valid Subscriber Agreements

While low attrition and sound account management practices are critical in the sale of your accounts, nothing is more important than your subscriber agreements. Valid and enforceable subscriber agreements not only help to establish your qualified account base, they are critical to protecting both your company and your potential buyer – before, during, and after the sale.

An important factor to buyers is that you have a valid agreement for each and every account you intend to sell. Your subscriber agreements must comply with state and federal laws, especially those relating to consumer contracts for residential accounts, and include specific information and key provisions to protect your company from legal and financial liability. Without contracts meeting the necessary legal standards and providing appropriate protections to your company (and a potential buyer), most buyers will view your accounts as worthless. More seriously, accounts without valid and appropriate contracts expose you and any buyer to huge potential legal and financial risks.

At a minimum, each and every account you want to sell must have a valid subscriber agreement, dated and signed by the subscriber and your agent. It must include all of the necessary information about the account: the date, the subscriber's name, site address, monthly billing amount, and phone number. The best subscriber agreement is assignable to another company and written simply and clearly, so that the terms, rights, and responsibilities are understandable by the subscriber and the provider.

Your company's subscriber agreements must also include language limiting your company's potential legal responsibility to the subscriber and its insurer. It should require the subscriber to insure against property loss, personal injury and claims by third parties, and should limit the subscriber's recovery to its insurance. A robust agreement also includes a "waiver of subrogation," which means the subscriber waives its insurer's right to file a claim against your company to recover payments made to the subscriber or third parties.

To protect your company in the case of a subscriber loss, your agreement should also include clauses limiting your company's financial responsibility to a specified amount and requiring the subscriber to pay for any claims brought by others, even if your company was at fault.

The best subscriber agreement is assignable to another company and understandable by the subscriber and provider.

Contracts for residential alarm services that are signed anywhere other than at your company's offices (subscriber's homes, booths at home shows, etc.) must give the subscriber three days to cancel the contract under the Federal

Trade Commission's "Cooling-Off Rule." State consumer protection laws, which vary from state to state, may also require very specific right-to-cancel language. To fully comply with the FTC's Cooling-Off Rule, your salespeople must explain the three-day right to cancel and must give two written copies of a form cancellation notice to use in the event of a cancellation request. The subscriber should also sign a form acknowledging the explanation of the right to cancel. You should keep a copy of the signed receipt in your account files to prove compliance with federal and state consumer protection laws.

Essentially, if you fail to follow these state and federal laws, your contract could be "voidable" by the subscriber. Accounts with potentially voidable contracts are worth much less to potential buyers because they have a high attrition potential.

Likewise, none of the contract's protective terms will apply to limit your responsibility or financial exposure, and your insurance company may refuse to cover any claims or to pay your costs if you are sued.

If your company has not documented every account with a valid agreement – or you don't know or cannot prove that this is the case – you can still take protective remedial measures.

If your company has not documented every account with a valid agreement – or you don't know or cannot prove that this is the case – you can still take protective remedial measures. Review your account records, identify any accounts that don't have proper contracts, and have the subscribers sign new contracts.

Manage Installation and Monitoring to Facilitate Easy Account Transfers

Although maintaining proper account documentation is critical, a high-value company will also anticipate the technical aspects of an eventual sale. The more difficult it is for a buyer to transfer and integrate your accounts into its monitoring system, the less the buyer will be willing to pay for those accounts.

For example, site visits to reprogram panels cost time and money – increasing the overall burden on a potential buyer seeking to integrate your accounts into its system. Good installation practices, including setting up panels to receive downloads remotely over the phone or IP, eliminate the need for site visits and manual reprogramming.

Using standard equipment on a company-wide basis, equipment that's both technologically sound and allows the system to grow to accommodate advances in technology and increased subscriber needs, also makes service easier and less costly down the road.

Knowing, understanding, and properly managing your relationship with your central station can also add value to your accounts and your company. For example, contracting with your central station to have clean receiver lines, those that handle only your company's signals, is essential to ensuring that your potential buyer will not encounter any technical issues in transferring your accounts to its central station. If you're sharing lines with other central station customers, your buyer likely will either require you to reprogram the accounts to receiver lines that you control prior to the sale, costing you time and money, or will pay you less for your accounts.

Owning your toll-free receiver number (or IP address if you transmit over IP) and having the appropriate ability to transfer the lines to a potential buyer's central station also ensures your buyer will not encounter any technical issues in buying your accounts.

The more difficult it is for a buyer to transfer and integrate your accounts into its monitoring system, the less the buyer will be willing to pay for those accounts.

If you are not sure if you own your receiver number or IP address, your monitoring agreement will tell you what services your central station provides.

The agreement will also specify your obligations to your central station, which may have an impact on the net benefit you receive from selling your accounts. For example, if your company has a long-term contract with a central station. If so, you may still be required to pay the central station until the end of the contract term, even if you sell your accounts.

Mitigate Risk with the Right Type and Amount of Insurance

Finally, a strategic and smart company will be insured appropriately. Potential buyers not only look for the key elements that make your accounts a good investment, but also at whether you would be a sound business partner, especially if you intend to have an on-going relationship. One key indicator is how your company manages risk through insurance.

The best way to make sure you have the right type and amount of insurance is to use a professional agent who will help your company put together a comprehensive insurance program. One that will not only pay for claims and losses, but may also pay for lawsuits against your company.

At a minimum, your program must include commercial general liability (CGL) coverage, which covers bodily injury and property damage claims related to your company's property, products and business operations, as well as other claims, like advertising claims. Security Services Professional Liability Insurance (also known as Security Services Errors & Omissions Insurance or Security E&O) protects your company if a subscriber claims your employee failed to perform their professional duties, or if your company's work doesn't perform as promised in your contract. It may cover not only the mistakes of your employees but also independent contractors you hire. It is essential for every company who designs, installs, or monitors systems (either itself or through a wholesale monitoring facility) to maintain errors and omissions insurance.

Potential buyers not only look for the key elements that make your accounts a good investment, but also at whether you would be a sound business partner. One key indicator is how your company manages risk through insurance.

Because your company likely collects, stores, and shares your subscribers' personal and financial information, you may also need Cybersecurity insurance. Cybersecurity insurance covers your company for any responsibility you have for data breaches and data loss, as well as the interruption of your business, loss of your computers, and other devices, and business expenses, including legal and credit monitoring expenses. Neither CGL nor Security Services E&O policies regularly cover these cybersecurity claims.

Every state also requires businesses with employees carry some form of Workers' Compensation Insurance, although the requirements vary from state to state. More importantly, if you have employees and you intend to continue to run your business after selling a portion of your accounts or to continue to service those accounts, potential buyers will require you carry Workers' Compensation Insurance that complies with your state's laws.

Your insurance not only must be the right type, but also the right amount. A consultation with an industry insurance professional to examine your exposure and risk will help to develop an insurance program that adequately protects you, the company, and the potential buyer.

Are You Ready?

Building a high-value business, one that potential buyers want to invest in, takes time, planning, and commitment. No matter what your goals or timeline, it's never too early to begin considering your liquidity options and taking action to get your accounts and your company in top shape.

Using this checklist will not only help you attract a trusted and experienced purchaser that will give you the most value for your accounts when you are ready to sell, but will help you build a solid company that will increase revenue for you until that time: