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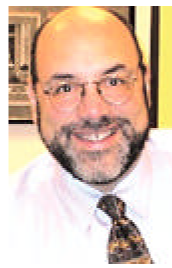
GUEST COMMENTARY

Should integrators sacrifice profits in favor of increasing revenue?

By Pete Sokoloff



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In the day-to-day challenge of running a company, managers may make decisions to go down a slippery slope and sacrifice profitability in favor of more revenue. What happens when this occurs in a security systems integrator's business? There is a way to manage expenses for greater profitability and thus build value for a successful exit strategy.

EBITDA, what is it?

Most systems integrators know that buyers will value their businesses by multiplying EBITDA times some multiple, typically, from four to six times. What is EBITDA?

EBITDA is earnings before interest, taxes, depreciation and amortization. It is used by managers to provide a good understanding of the day-to-day operating performance of their companies. Simply put, EBITDA is all revenue from operations less all operating cash expenses.

EBITDA margin is expressed as a percentage of revenue. In a survey of 28 security integrators, it was found that overall margins varied substantially. Twenty-eight percent of the companies produce EBITDA margins of 15 percent or better. Thirty-six percent have margins between 10 percent and 14 percent, while 32 percent have single digit margins.

EBITDA vs. revenue growth

Which is a better scenario? Growing revenue faster and reducing EBITDA margins, or increas-ing EBITDA margins, even if it means slowing revenue?

A slow, or no-growth company, which might sell for a four times multiple and has 15 percent EBITDA, is potentially worth the same as a rapid revenue growth company that trades at six times and has a 10 percent EBITDA margin. It is easy to conclude that EBITDA, which translates into profitability, should not be sacrificed for revenue growth.

Improving margins

Well-run systems integrators regularly produce 15 percent EBITDA margins. What's the secret to converting a single digit margin company into a stellar EBITDA performer? Well-run companies have much more than the inside line on negotiated bids. In fact, some of the high margin performers surveyed derive most of their business from competitive bids.

Here are some methods that strong systems integrators tend to employ:

Lean and mean management - A project manager does not

Current Issue

just drive around and check on jobs. He carries tools and gets hands-on so that he is a senior tech with project manager responsibilities.

Above 80 percent employee productivity - This is actual on-the-job time, delivering billable services. Technician production time is not eaten up by having them show up at the shop every morning for coffee and orders or to pick up a truck. Know how long certain jobs should take and track and schedule accordingly.

Keep a lid on hiring while increasing productivity - Track revenue per employee every month and keep this number moving upward. Security systems integrators vary from a low of $100,000 to as high as $450,000 of annual revenue per employee.

Clean house - Based on revenue per employee, if the operation is fat, use Jack Welch's (former chief executive officer of General Electric) policy of regularly cleaning out the bottom 10 percent of employees. Do not replace them unless there is a tactical benefit (tactical means that they pay for themselves with a good margin immediately).

Standard acceptable margins are built into job costing - Have a sliding scale on account manager commissions that drops the commission percent as the gross margin drops.

Strong financial and management reporting - Reports are used to run the business.

EBITDA numbers are known and used. Strong managers are aware of gross margin, and are controlling it, along with general and administrative overhead, to produce superior EBITDA and profitability.

Simply put - Improve EBITDA, generate greater profits and get more for your business!

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