Security industry expectations high

By jgriffin
Published: Aug 31 2010 - 5:21pm

magazine_article_issue: SDI - September 2010 : Jeff Kessler Live Date: Aug 31 2010Subtitle: Renewal of growth in 2010Article Body:

For the $180 billion security industry, by our estimates, 2010 is turning out to be the breath that refreshes after a major time-out by clients in 2009 to think about return on investment (ROI), total cost of ownership and future proofing.

In 2009, despite gains by (1) Internet Protocol (IP) video management systems and physical security information management (PSIM) providers, (2) a few selected (and smart) integrators, and in (3) recurring monthly revenue (RMR) generated by service companies, the overall industry was at best flat and likely contracted in the low single digits. However, some vertical markets and installers were down as much as 15 to 30 percent. Despite consumer unemployment woes in 2010, the overall tenor of the security industry is much more positive now. One of the reasons for the improvement in 2010, based on interviews with end-users, was due to much more than a mere rebound from the corporate paralysis that hit in 2009. The recession actually provided C-level executives with an opportunity to step back, take a deep breath and assess whether they really wanted to keep upgrading legacy systems or start spending to "future-proof" their security by bridging to IP networks or simply going straight to IP. Senior executives also became more educated and more demanding regarding the specific security solution they needed. This is reflected in both the continued decline in all analog-related security sales and the acceleration in IP related sales-not just in video.

Consumer and small business monitoring

Following a tough but resilient 2009 in which new sales declined despite increases in RMR, and in which consumers continued to complain about rising prices, the consumer and small business monitoring segment is now in a state of flux-we think for the better. Several leading companies were sold or refinanced and the industry faces a host of upcoming issues ranging from alarm verification and police response times, to POTS and ultimately GSM sunsets, to be replaced by broadband and new wireless communication protocols (possibly even WiMax and mesh). New marketing trends are also roiling the industry, including sophisticated SEO and SEM Web-based marketing and smarter summer programs that, with better sales training, have drastically reduced the number of complaints. All this has increased the scrutiny paid to the metric of the cost of creating new customers. With all these issues, we can realize the potential of consumer penetration breaking through the 20 to 30 percent barrier toward 50 percent if new, enhanced services being offered today, in their infancy (video verification and surveillance, PERS, remote metering, personal services, etc.) are accepted by a new wireless generation as part of their lifestyle. Certainly those companies that are of the view that they can continue to raise RMR without commensurate value perception by the customer will lose market share.

The value-add delivers revenue

Just how are integrators creating value and margin in 2010? One difference in 2010 is that the large integrators are carving out highly-trained divisions to install and support PSIM and other security event management-level solutions. Other integrators are moving toward managed access and, more recently, managed video offerings. Still other integrators are adding pre- and post-project planning and analysis and future-proofing services to clients. Previously, the only consistent integrator service had been field service and maintenance. This is a sea change that a few of the integrators will embrace and under which they may even thrive. Unfortunately, we only foresee a minority of integrators moving to this model, leaving a majority of integrators to continue to struggle with profit margin pressures because they lack the capital and scale to adapt their business model (as described above) and ability to re-purpose their personnel to become more IT-oriented.

An offshoot of this is the move to more managed and network-based services being added by integrators putting pressure on third-party monitoring companies to invest in more robust communication and network-capable monitoring and systems that can handle IP networked infrastructures. This will weigh in favor of larger, better capitalized third-party monitoring centers.

With the exception of the very largest security companies who can choose between direct or channel-based go-to-market strategies, we are seeing the channel of integrators and dealers hold up as long as they satisfy the demands of increasingly savvy and demanding end-users. The Internet has allowed end-users to become much more cognizant of product and labor costs, ROI considerations, the types of remote services available and the types of in-house services they want to keep. They are better educated on what type of security solution they need, not simply what the integrator or dealer wants to sell. End-users also are demanding that providers of products to the integrators, be they VMS or service providers to the channel, be available to help them solve problems before, during and after installation. Going to market via a referral from a happy customer is therefore becoming an increasingly important means to make a profit and increase market share and brand for everyone from manufacturers to integrators.

Growth trends in 2010

Even if the industry as a whole does not grow 10 percent in 2010, as some predict, some sectors we have discussed will continue to exceed 25 percent and even 50 percent growth. Older legacy and analog segments in physical security would be the culprits holding total percentage gains down. Margins are still holding up on many higher-end cameras and access equipment (like biometrics), but there is compression taking place as more product gets produced in low-cost countries and end-users become more savvy about price lists. Ultimately, all product margins have to come down, though the value they provide should, we believe, cushion integrators from seeing anything close to what happened to product and installation in the IT integration space.

The continued adoption of standards for IP video (PSIA or ONVIF) may certainly put pressure on product margins but should be extremely helpful in allowing application writers to increase the functionality of video at lower cost. This should improve the growth of IP video which fell from 30 to 40 percent growth rates in 2007 to 15 percent in 2009.

Both the high-yield market and private equity interest in technology and recurring revenue has been very strong. We have seen senior lenders slightly loosen their criteria for advance rates and covenants, which has helped support industry growth and investment. Senior lenders also have broadened their knowledge base in the security industry on what constitutes recurring revenue from alarms to video surveillance and managed services. Transactional activity in the industry has been robust, as evidenced by the largest companies, ADT and Stanley, digesting major acquisitions, the Devcon and Protection One alarm monitoring transactions and a spate of smaller deals, and L-1's announcement that they are looking at "strategic alternatives." Nevertheless, we see the likelihood for continued significant M&A and financing activity in the market in the near term, signs that security continues to move forward with refreshing results.

PSIM and Leading Video/Access Managed Service Companies

In 2010 government, critical infrastructure (transportation and power) and institutions which are focused on large installations increasingly have been expressing a desire for PSIM or other brand name device integration capability in their projects. This is one area where every major PSIM provider has seen growth, some spectacular, albeit off of relatively small revenue bases.

Collapse of Horizontal Layering in Video

Three years ago, IP video software platforms, manufacturers and video management systems (VMS) providers were discreet-and partnering with each other. Now, many of the leaders in these segments may still be partnering with each other but increasing numbers of manufacturers and platform software providers seem to be offering their own VMS in response to customers demands for a one-stop solution. Increasing client demands for a video "solution" puts more pressure on margins from individual, discreet, product companies (unless that product is exceptional, market leading, or "bleeding edge").

ENTERPRISE SECURITY

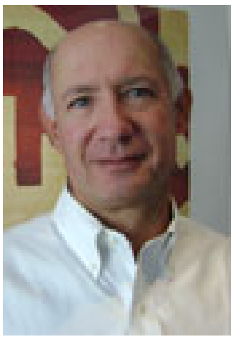
Major developments in 2010 include:

- Formal industry acceptance of remote, managed access and video monitoring services;

- PSIM as a differentiator in obtaining large contracts;

- More evidence that the IT "takeover" of the industry is an internal matter, with personnel turning over rapidly instead of the long-feared outside "hordes" of IT integrators taking share; and

- On a case-by-case basis, vendors, integrators and end-users seemingly settling on a menu of video analytics to provide the highest utility for given projects. This has both improved the reputation of analytics and caused several vendors to integrate (or acquire) analytics as part of their own offerings.



Jeff Kessler is managing director for Imperial Capital LLC, New York, N.Y. He can be reached at JKessler@imperialcapital.com .