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APi Group Corp. (APG)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to APi Group's Fourth Quarter 2021 Financial Results Conference Call. All participants are now in a listen-only mode until the question-and-answer session. Please note this call is being recorded. I will be standing by should you need any assistance.

I will now turn the call over to Olivia Walton, Vice President of Investor Relations at APi Group. Please go ahead.

Olivia Walton

Vice President-Investor Relations, APi Group Corp.

Thank you. Good morning, everyone, and thank you for joining our fourth quarter 2021 earnings conference call. Joining me on the call today are Russ Becker, our President and CEO; Kevin Krumm, our Executive Vice President and Chief Financial Officer; and Sir Martin Franklin and Jim Lillie, our Board Co-Chairs.

Before we begin, I'd like to remind you that certain statements in the company's earnings press release announcement and on this call are forward-looking statements, which are based on expectations, intentions, and projections regarding the company's future performance, anticipated events or trends, and other matters that are not historical facts. These statements are not a guarantee of future performance and are subject to known and unknown risks, uncertainties, and other factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements.

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In our press release and filings with the SEC, we detail material risks that may cause our future results to differ from our expectations. Our statements are as of today, March 1, and we have no obligation to update any forward-looking statement we may make.

As a reminder, we have posted a presentation detailing our fourth quarter financial performance on the Investor Relations page of our website. Our comments today will also include non-GAAP financial measures and other key operating metrics. The reconciliation of and other information regarding these items can be found in our press release and our presentation.

It is now my pleasure to turn the call over to Martin.

Martin E. Franklin

Director & Co-Chair, APi Group Corp.

Thank you, Olivia. We're very pleased with APi's progress achieved in 2021, and even more excited about the opportunities that lie ahead for the business. The completion of the acquisition of the Chubb fire and security business on January 3, 2022 was an exciting milestone as we continue our evolution and growth as a public company. Chubb is a business with significant strategic value to APi and won with multiple levels for value creation. We view APi's and Chubb's strength and skill sets as complementary, just as our capabilities and scale will help drive growth at Chubb, by the same token the addition of Chubb enriches our overall portfolio.

Our combined global reach as the world's leading life safety services provider is already unlocking incremental opportunities for us with multinational clients. We are thrilled to welcome all of the Chubb team members to the APi family as the business shifts from a noncore asset to a paramount strategic priority within APi.

As the bar is being raised at the operating level, so too is the bench of senior management. Multiple hires have been made to incorporate our growing scale, and we feel very energized with the quality of the team moving forward. We have great confidence in the business and the direction we're heading and look forward to updating you on our progress in the coming months.

Before handing over the call to Russ, I'd like to acknowledge with a heavy heart the passing of Lord Paul Myners in January. Paul was an outstanding director for APi and someone who made the world a more interesting and better place. He'll be greatly missed.

With that, Russ?

Russell A. Becker

Chief Executive Officer, President & Director, APi Group Corp.

Thank you, Martin, and good morning, everyone. Thank you for taking the time to join our call this morning. Before we provide you with a summary of our strong results for 2021, solid outlook for 2022, and an update on the acquisition of Chubb, I would like to start by thanking our team members who have remained focused on supporting our company and our customers. Their ongoing leadership efforts continue to demonstrate what I have known to be true since I was fortunate enough to be given the leadership role at APi over 20 years ago. Our leaders are a competitive advantage and help drive shareholder value. The safety, health, and well-being of all of our leaders remains our number one priority. Like Martin, I would like to welcome all of the Chubb team members to the APi family.

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As discussed at the investor conferences last week in Miami, 2021 was a watershed year in the development of APi. Despite the many macro headwinds, I am proud of our team and how we achieved our stated strategic goals amidst ongoing supply chain disruptions, inflationary pressures, and COVID-19 impact. These include the following highlights for the year ended December 31, 2021.

First, net revenues excluding Industrial Services increased on an organic basis by 16.1%, exceeding our initial guidance of 7%, driven by strong demand in our core Safety and Specialty Services segments.

Second, continued success in our ongoing goal of growing the acyclical recurring service revenue aspect of our portfolio, which we believe helps to build a more protective moat around the business. Service represented approximately 43% of total net revenues in our life safety businesses, up from approximately 41% of total net revenues in 2020.

Third, within our Safety Services segment, we achieved our goal of growing inspection revenue 10%-plus. We continue to drive our go-to-market strategy of selling inspection work first, which we believe will lead to further service revenue growth and ultimately drive margin expansion.

Fourth disciplined project and customer selection. We ended the year with a contract loss rate of less than 0.5%. This exceeds our goal of 0.7% or less. We will continue to resist lower margin, higher risk activity, and work to drive this toward zero. It is critical for us to maintain our focus on thoughtful and profitable growth rather than growing for the sake of growth and risking profitability as we strive to deliver on our margin expansion goals.

The most exciting development during the year was the signing of the definitive agreement to acquire Chubb on July 26, 2021. With the closing of the transaction, we began 2022 as the world's leading life safety services provider. I would like to spend a few minutes providing you with an update on our progress over the past couple of months.

As many of you have heard me say previously, Chubb is the center of the fairway transaction for us. We have built a branch-based business model similar to Chubb over the past 20 years since I've been at APi. Our Powered by APi structure provides us with the ability to leverage our scale while also being able to be nimble and opportunistic at the local level with minimal bureaucracy and overhead burden. We are excited to add Chubb to our family of market-leading service providers run by entrepreneurs with the backing of a large organization.

Another parallel between the Chubb business and APi is that we have life safety businesses that deliver high teens adjusted EBITDA margins, which means we also have businesses that are performing below the fleet average. We believe there is significant opportunity to invest in regions with higher margins and provide increased support to the Chubb team in improving the businesses that are below fleet average to ultimately realize the financial profile in line with APi Safety Services segment. We fully intend to leverage this approach to drive the growth of the newest member of the APi family.

We have now begun our three-year journey to accelerate organic revenue growth, leverage our scale, and drive margin expansion across our platform while focusing on free cash flow conversion and swiftly deleveraging and integrating the Chubb team and portfolio into APi. The views we had shared regarding the Chubb business on previous conference calls were based largely on the due diligence we performed as part of the transaction. I'm delighted to say that after nearly two months of ownership, we see the opportunities to be at least as large, if not greater, than we had anticipated during our due diligence. Kevin will touch on synergies briefly in his remarks.

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On future conference calls, we intend to highlight in more detail the areas we have identified that will drive synergies and margin improvement for the future as we work towards achieving our 2025 goals. This is likely the last conference call where I will reference Chubb. Chubb is an important brand within APi. For too long, in my opinion, under prior ownership, Chubb has been an orphaned asset as we have called it. That ended on January 3. As we have started to integrate the business, we are combining teams and resources, servicing customers, developing action plans, and moving forward as one company and team with a unified set of goals and direction.

As many of you know, and as we strongly believe at APi, our success is dependent on people. And one of the intangibles in any transaction is the people. We have a team of people on the ground, 24/7. We have built out the depth of our bench over the last several months to ensure that we are well-positioned to integrate and manage our ever-expanding global footprint. We have added several leaders with significant international and integration experience across all disciplines of our organization.

Since the closing of the Chubb transaction, Kevin, myself, and a number of our teammates have had the pleasure of traveling to numerous facilities to conduct operating reviews. Across the board, we have seen that there is genuine belief and desire that for the first time in many years, Chubb has found a stable home where the employees and their businesses can flourish and achieve their potential. As part of the APi family, Chubb will benefit from APi's culture of organizational sharing of knowledge and best practices and collaboration across businesses, which ultimately drives cross-selling opportunities.

I continue to be energized by the host of opportunities in front of us. As we look ahead to 2022, our record backlog continues to build and provides us with a solid foundation for organic growth. Underlying demand in our key end markets such as data centers, fulfillment and distribution centers, health care and high-tech remains robust.

As many of you have heard us say previously, while our business is not immune to macro marketplace disruptions related to the supply chain disruptions and inflationary cost pressures, we believe we have more tools to mitigate these pressures than our peers. The acquisition of Chubb has enhanced our overall competitive position and our protective moat around the business.

Our average project size in our largest segment, Safety Services, is now approximately $5,000; and the average duration of our projects is very short, which we believe will allow us to reasonably control inflationary variables and reasonably manage our supply chain. We believe these are competitive advantages as they allow us to stay focused on real-time pricing and operational efficiency to ensure true costs are reflected in the services we provide.

In summary, I am pleased with our progress in 2021 and confident that the momentum will continue into the future. We intend to maintain our relentless focus on growing recurring service revenue, disciplined project and customer selection, pricing opportunities, leveraging our spend, driving operational excellence, and realizing synergies from the acquisition of Chubb.

I would now like to hand the call over to Kevin to discuss our financial results and outlook in more detail. Kevin?

Kevin Krumm

Chief Financial Officer & Executive Vice President, APi Group Corp.

Thanks, Russ, and good morning, everyone. I'll begin my remarks by reviewing our consolidated results and segment-level operating performance before turning to our outlook. Net revenues for the three months ended December 31, 2020 increased on an organic basis by 27.4% compared to the prior year period when excluding

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Industrial Services. For the year ended December 31, 2021, net revenues increased on an organic basis by 16.1% compared to the prior year period. This, too, is excluding Industrial Services.

Adjusted gross margin for the three months ended December 31, 2021 was 24.6%, representing a 42-basis-point decline compared to the prior year, driven by supply chain disruptions and inflation, which caused downward pressure on our margins. This was partially offset by outsized growth in our higher margin Safety Services segment and an increase in inspection and service revenue.

For the year ended December 31, 2021, adjusted gross margin was 24%, representing a 30-basis-point increase compared to the prior year due to an improved mix of inspection and service revenue and outsized growth in our higher margin Safety Services segment, which represented approximately 53% of adjusted net revenues in 2021 compared to approximately 47% in 2020. This was partially offset by supply chain disruptions and inflations, which have caused downward pressure on our margin.

Adjusted EBITDA margin for the three months ended December 31, 2021 was 10.3% compared to 11.8% in the prior year period, driven by continuing supply chain disruptions and inflation, which caused downward pressure on our margins, as well as lower contribution from joint ventures in our Specialty Services segment. This was partially offset by outsized growth in our higher margin Safety Services segment and an increase in inspection and service revenue. For the year ended December 31, 2021, adjusted EBITDA margin was 10.3%, representing a 57-basis-point decline compared to the prior year due to the items I mentioned for the fourth quarter.

As many of you know, one of APi's historical strengths is its strong free cash flow, which creates opportunities to drive organic and acquisition growth, as well as flexibility to make the best capital allocation decisions, whether debt repayment, acquisitions, or otherwise.

As we have noted on prior calls, our substantial growth in organic net revenues throughout 2021 increased working capital investment as we ended Q4 2020 with suppressed working capital levels, primarily due to a reduction in volume during 2020, driven by the pandemic. For the year ended December 31, 2021 adjusted free cash flow was $223 million, representing a $220 million decrease compared to the prior year of $443 million. And our adjusted free cash flow conversion rate was approximately 57% – or 55%, which was impacted by higher than anticipated demand in the fourth quarter in our core Safety and Specialty Services segment.

I will now discuss our results in more detail for each of the three segments beginning with Safety Services. Safety Services' net revenues for the three months ended December 31, 2021 increased on an organic basis by 23%, primarily due to continued growth in inspection and service revenue across the majority of our markets. For the year ended December 31, 2021, net revenues increased on an organic basis by 17.6% due to continued growth in inspection and service revenue across the majority of our markets and general market recovery compared to the prior year period, which was negatively impacted by the pandemic.

Adjusted gross margin for the three months ended December 31, 2021 was 30.9%, representing a 180-basis-point decline compared to the prior year driven by supply chain disruptions, which caused a decline in productivity. This was partially offset by an improved mix of inspection and service revenue for our life safety businesses. For the year ended December 31, 2021, adjusted gross margin was 31.5% compared to prior year adjusted gross margin of 31.9%, driven primarily by the factors mentioned as drivers for the fourth quarter.

Adjusted EBITDA margin for the three months ended December 31, 2021 was 13.5%, representing a 12-basis-point increase compared to the prior year due to the increase in inspection and service revenue, which was partially offset by certain supply chain disruptions. For the year ended December 31, 2021, adjusted EBITDA

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margin was 14%, representing a 32-basis-point increase compared to the prior year due to an improved mix in inspection and service revenue. This was partially offset by the return of largely temporary cost containment efforts implemented to counteract the negative impact of the pandemic in 2020.

I will now discuss our results in more detail for Specialty Services segment. Specialty Services' net revenues for the three months ended December 31, 2021 increased on an organic basis by 36.6%, primarily due to increased demand and timing for our fabrication and specialty contracting services. For the year ended December 31, 2021, net revenues increased on an organic basis by 18% due primarily to the factors mentioned as drivers for the fourth quarter.

Adjusted gross margin for the three months ended December 31, 2021 was 18.1%, representing a 47-basis-point increase compared to the prior year due to an increase in service revenue and improved productivity. This was partially offset by supply chain disruptions and inflation, which caused downward pressure on margins. For the year ended December 31, 2021, adjusted gross margin was 16.2%, consistent with prior year due to an increase in service revenue, disciplined project and customer selection, and improved productivity which was partially offset by supply chain disruptions and inflations which caused pressure on margins.

Adjusted EBITDA margin for the three months ended December 31, 2021 was 12.5%, consistent with prior year due to the items I noted for gross margin performance, along with lower contribution from joint ventures compared to the prior year period. For the year ended December 31, 2021, adjusted EBITDA margin was 11%, representing a 100-basis-point decline compared to the prior year due to supply chain disruptions and inflation which caused downward pressure on margins, the return of largely temporary cost containment efforts implemented to counteract the negative impact of the pandemic in 2020 and lower contribution from joint ventures compared to the prior year. These factors were partially offset by an increase in service revenue, disciplined project and customer selection, and improved productivity.

I'll now discuss our results in more detail for our Industrial Services segment. Industrial Services' net revenues for the three months and full year ended December 31, 2021 declined on an organic basis by 6.9% and 41.7% respectively, showing some recovery towards the end of the year. The decline was driven by our continued focus on disciplined project and customer selection, decisions by our customers to delay and/or suspend certain project and difficult industry conditions. Adjusted gross margin and adjusted EBITDA margin for the three months ended December 31, 2021 was 13.6% and 7.4% respectively compared to 14.9% and 12.6% respectively in the prior year period. The decline was driven by unabsorbed cost releases and equipment due to lower volumes. This was partially offset by an improved mix of service revenue.

For the year ended December 31, 2021, adjusted gross margin and adjusted EBITDA margin was 7.9% and 4% respectively, compared to 16.3% and 13.6% respectively in the prior year period. The decline was primarily due to unabsorbed cost releases and equipment due to the lower volumes. This was partially offset by an improved mix of service revenue, disciplined project and customer selection, and certain cost reduction actions taken in the segment.

Before I review our 2022 guidance in more detail, I would like to note that this will be the last call – this will be the last time that we discuss results for the three segments as we have realigned our management reporting structure following the Chubb acquisition. Effective January 1, 2022, the historical Industrial Services and Specialty Services segments will be reported as one segment, Specialty Services, and the historical Chubb business will be reported within Safety Services. As a result, we will present financial information for two segments moving forward. The segments will be Safety Services and Specialty Services.

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I will now discuss our outlook for 2022. We began 2022 focused on delivering our mid-term plan of continued healthy top line growth in line with our average historical organic growth trend of 6% to 7% as we continue to focus on driving our adjusted EBITDA margins to 13% by 2025. As stated in our February 23 press release, we believe that net revenues for 2022 will range between $6.3 billion to $6.5 billion, driven by our relentless focus on growing recurring service revenue. We expect Q1 to be $1.375 (sic) [$1,375] million to $1.43 (sic) [$1,430] million, Q2 to be $1.575 (sic) [$1,575] million to $1.625 (sic) [$1,625] million, and the second half to be $3.35 (sic) [$3,350] million to $3.445 (sic) [$3,445] million.

In line with our historical performance for 2022, we expect growth in net revenues on an organic basis at constant currencies will be 6% to 7%. For 2022, we expect to deliver between $650 million to $700 million of adjusted EBITDA. Where we end within this range will largely be dependent on the speed with which we finalize and implement certain integration activities across our platform, the impact of further supply chain disruptions and inflationary pressures, our revenue growth, and exchange rate movement during the year.

As we've spent more time with the Chubb business post-close, the saving opportunities are becoming more tangible, and we believe we have line of sight to delivering the $20 million of annualized opportunities we identified during our original diligence process. There's a lot of work left to do if we are to execute successfully on all these opportunities. While we expect the acquisition to be immediately accretive in 2022, excluding restructuring and onetime charges, we anticipate that most of the projected operating synergies will take place – will take 18 to 36 months to realize.

We expect Q1 adjusted EBITDA to be $120 million to $130 million, Q2 to be $165 million to $185 million, and the second half to be $365 million to $385 million. Depending on how interest rates move throughout the year, we anticipate interest expense for 2022 to be approximately $120 million. We expect depreciation expense to be approximately $85 million and capital expenditures to be approximately $90 million. As a result of the acquisition of Chubb, we anticipate our adjusted effective cash tax rate to increase to approximately 24%. Our adjusted diluted weighted average share count for the fourth quarter was 229 million and will be approximately 269 million for the first quarter in 2022.

As discussed on prior calls, for the $800 million perpetual preferred equity financing in connection with the Chubb transaction, there is a 5.5% annual dividend payable on a quarterly basis in cash or, at the company's option, in kind by payment of additional shares of common stock. We will decide at the time the dividend is due whether we will pay in cash or stock based on the company's cash flows and balance sheet position. For the first quarter, we have communicated our intent to pay in cash. The annual dividend amount is expected to be approximately $44 million and the perpetual preferred may be converted at any time by the holder into common stock at a conversion price of $24.60.

From a capital allocation perspective, our near-term focus remains on deleveraging through the high free cash flow conversion offered by our asset-light operating model. Following the close of the Chubb transaction on January 3, our net-debt-to-adjusted-EBITDA ratio was approximately 3.9. We expect to deliver on our average adjusted free cash flow conversion of approximately 80% over the coming years and intend to use the cash generated to reduce debt on average by approximately 1 time annually to return to our targeted long-term range of 2 to 2.5 times.

I will now turn the call over to Jim.

James E. Lillie
Director & Co-Chair, APi Group Corp.

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Thanks, Kevin. APi's execution against this goal despite supply chain disruptions, inflationary pressures, and COVID-19-related disruptions speaks to the strength of the company's recurring revenue, services-focused business model, the discipline of the organization, and its leadership team as we continue to focus on shareholder value creation.

As Russ mentioned, we entered 2022 with positive momentum on many fronts. Notably, the Chubb acquisition meets our previously stated key strategic investment criteria. Chubb has a history of strong free cash flow generation. They are leaders in their niche markets and they have an experienced leadership team. The acquisition significantly expands our geographical reach from 200-plus locations to 500-plus locations and strengthens our protective moat through greater statutorily required activities, recurring revenue with 50%-plus of our revenue now coming from service-related activities. As we begin the process of integrating Chubb, we are simultaneously investing in the growth of its platform and generating synergies across our combined platform.

To help drive value and deliver on our commitments, we have enhanced our team with new global leaders adding depth to our bench as we plan for the future together as one team united by market-leading brands across the globe. As we move forward, we believe our combined leadership team will drive towards maximizing business performance and capitalizing on future cross-selling opportunities. Our aligned and incentivized performance-based culture will help drive Chubb as it has at APi.

We are focused on making the right choices for the long-term health of the business, being opportunistic on M&A, and remain focused on creating sustainable shareholder value. While we expected to be at a net leverage ratio of around 4.1 times at closing of the Chubb transaction, as Kevin mentioned, our net-debt-to-adjusted-EBITDA ratio was approximately 3.9 times following the close and our revenue backlog remained at a record high level. Both of these metrics are great indicators of the positive momentum in the business. We have a very healthy balance sheet and strong organic revenue prospects for the year ahead.

With that, I'd like to now turn the call back over to the operator and open the call for Q&A. Catherine?

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll take our first question today from Markus Mittermaier with UBS. Your line is open.

Markus Mittermaier
Analyst, UBS

Q

Hi. Good morning, everyone.

James E. Lillie
Director & Co-Chair, APi Group Corp.

A

Hey, Markus.

Kevin Krumm
Chief Financial Officer & Executive Vice President, APi Group Corp.

A

Good morning, Markus.

Markus Mittermaier
Analyst, UBS

Q

Hey, morning.

James E. Lillie
Director & Co-Chair, APi Group Corp.

A

And, Markus, congratulations on the baby.

Markus Mittermaier
Analyst, UBS

Q

Oh. Thank you very much. Could I maybe start with Russ? I know that you visited a lot of sites of Chubb over the recent weeks. What's your kind of impression compared to the expectations that you had during the due diligence now that you've actually seen the folks?

Russell A. Becker
Chief Executive Officer, President & Director, APi Group Corp.

A

Yeah. Thanks. Thank you, Markus. I would say better than expected. And I mentioned in my remarks that Kevin, myself, and a number of our teammates, we spent really the first eight or nine days after the transaction closed, moving around to a number of different locations inside the Chubb organization; and I was impressed. And the branch leaders really grew up in the business. They're really solid, good operators. I felt really good about the quality of the leadership. The country-level leadership both the UK was really solid, and I felt really positive about it.

I think that one of the things that has been missing in the past was visibility from the company's leadership in the businesses and in the branches, and that was really obvious as we moved around and really got a chance to interact with all of the different team members in the different locations that we're at and how enthusiastic they were.

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We also – while we were there, we also had a town hall meeting that we opened up to every single one of the Chubb employees across the globe. And we had 2,700 people participating in that session. So, doing that virtually was not the easiest and maybe not the most efficient, but the enthusiasm and the excitement that came across from our new teammates was fantastic. The chat line was like lit up and on fire, and it was really cool. And I personally came away from that trip really fired up and – about the opportunities that are in front of us. And I think that our culture and purpose of building great leaders is exactly what's missing. Those team members need investment in them as people, just like we've been investing in the employees of APi. So, better than expected.

Markus Mittermaier
Analyst, UBS

Q

That's very helpful color. Thank you. And then maybe in terms of the revenue guide, the 6% to 7% organic, obviously, I guess on the legacy APi business now, how should we expect these new additions on the Chubb side to develop? Should we expect some sort of revenue or project selectivity here in the first year? You mentioned that particularly in the life segment – life safety segment, you have high-teens margin. How do you think about that? I know it's early days and you're probably still going through the various P&Ls, but how big is that opportunity on the revenue selectivity side?

Russell A. Becker
Chief Executive Officer, President & Director, APi Group Corp.

A

Well, I think there's a few things at play as it relates specifically to Chubb. Chubb had year-on-year revenue growth last year of roughly 5% even though they were off in the fourth quarter approximately 3% on a comparison to 2020. Most of that was driven by supply chain issues and the pandemic. We believe that once we kind of get moving forward with Chubb, that we should be able to generate organic growth at a clip very similar to APi's on traditional. We do need to spend more time understanding the end markets that they serve. They have more exposure to retail as an example than, say, our current business does. They don't have a significant issue with collections and receivables, etcetera. But we will spend some more time on customer selection and project selection as we get involved.

We have instituted our same kind of no go, go policy that we use for APi when we're proposing on larger opportunities inside of Chubb already. So, we'll start to see more of those kind of flow through the system as well. Chubb's average project size happens to be smaller than the average project size for core APi. The percentage of service that they do is roughly 60%. So, that's very complementary to our portfolio. So, we're opportunistic, but we're still kind of gathering information and evaluating where they're at.

Markus Mittermaier
Analyst, UBS

Q

Great. Thanks so much. I'll get back in the queue. Good luck.

Russell A. Becker
Chief Executive Officer, President & Director, APi Group Corp.

A

Thanks, Markus.

Operator: We'll go now to Andy Kaplowitz with Citigroup. Your line is open.

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Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Good morning, everyone.

Russell A. Becker
Chief Executive Officer, President & Director, APi Group Corp.

A

Hey, Andy. How are you?

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Good. Russ, it seemed like you had a relatively big sequential acceleration in Q4, both in Safety and Specialty Services. Well, I think you mentioned maybe a little bit of pent-up demand in Safety, but did you see projects start to flow more regularly in Specialty, or maybe you can comment on taking share? Could you give us a little more color into the reasons for the acceleration? And did it continue into Q1?

Russell A. Becker
Chief Executive Officer, President & Director, APi Group Corp.

A

Yeah. I think you have a little bit – I think you have a number of things really at play there, Andy, specifically in Safety Services. That's where our HVAC services businesses lie. They – if you go back to 2020, they had a number of their project-related opportunities slip out to the right. As I mentioned at your conference, we were fortunate that most of those opportunities did not get canceled. They just slid from a schedule perspective, and we saw some of that really start to flow through the system here again in 2021, right up through the end of the quarter.

We also – if you switch to the Specialty Services, we have – our structural manufacturing business happens to be fortunate to call Amazon a customer of ours, and the demand there has remained robust. And so we've been able to capture a number of nice opportunities there. We also have some larger project-related opportunities that really continue to be really strong right up through the end of the year. So, we just – I think it was just really fortunate for us with some of the project-related opportunity that we had on the books already.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

That's very helpful, Russ. And then could you give us more color? You gave us quarterly cadence now in sales and EBITDA because it looks like you assume more normalized margin in Q2 versus Q1. So, how are you thinking about labor pressure, supply chain, on your margin versus your pricing? Is it true that you're assuming more normalized environment in Q2, or does the guide still incorporate some supply chain-related headwind for the rest of the year?

Russell A. Becker
Chief Executive Officer, President & Director, APi Group Corp.

A

Well, we expect supply chain to – supply chain issues to be I guess problematic through, for sure, in the second quarter. I would also tell you that just the mindset and the way we approach things here is that, that's our responsibility to manage. And so we can't use that as a crutch as we continue to lead the business, and that's just part of the process. So, we do expect to continue to battle supply chain inflation. Obviously some of the things that are happening in our world will continue to have impacts on that.

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Labor is tough, and you have a – I view it as being more geographically market-specific. I also believe that our core purpose of building great leaders and in our willingness to invest in the men and women that are actually getting the work done in the field at our customers sites is an advantage for us. And I think that that's something that's positive where if we can retain our labor force first, then that allows us to continue to build and add.

We've also done some really creative things like one of our businesses has created an apprenticeship program that's actually certified and – for fire alarm technicians. So, we're able to hire and grow our own fire alarm technicians, and we're doing some things across the business. We've got some really interesting and unique hiring programs, taking advantage of the men and the women that are exiting the military service. And so we continue to be creative as we look to complement and build out our workforce and – because that's something that's very important to us as being in a people-centered business.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Russ, just a very quick last one. No exposure to Russia/Ukraine for legacy or new business?

Russell A. Becker
Chief Executive Officer, President & Director, APi Group Corp.

A

None.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

James E. Lillie
Director & Co-Chair, APi Group Corp.

A

Thanks, Andy, and good conference.

Operator: We'll take our next question from Julian Mitchell with Barclays. Your line is open.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Thanks very much. And, Jim, good to see you last week, and I hope you'll say that was a better conference. But in terms of perhaps the free cash flow first off, just wanted to talk about the expectations there. You had free cash flow, I think, half of last year, and then the conversion in the mid-50s. As we look at 2022, you've got maybe some easing of the working cap headwind, but then Chubb's cash flow coming in. So, how do we think about free cash conversion in aggregate this year or sort of percentage increase?

Kevin Krumm
Chief Financial Officer & Executive Vice President, APi Group Corp.

A

Hey, Julian. This is Kevin. I'll take that. Yeah. So, just as we've talked about previously, 2020 was a year where we consumed working capital as revenue came down throughout that period because of the pandemic. So, we ended 2020 with a very low working capital base. As we came back in 2021, we continued to invest in working capital. We talked on the last call about how Q4 was going to be a strong period for us, which it traditionally is. The only difference there was we over-delivered versus anticipate – or expectations in Q4. So, didn't harvest as

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much from Q3 to Q4 as we thought, but still a very strong delivery in Q4 ending at 55%. When you – whereas we move into 2022, of course, there'll be some additional investment.

We're going to continue to work on working capital rate. I'll say the profile of Chubb's free cash flow delivery is very much in line with our expectation in the delivery of our Safety Services segment. So, we definitely – and as we move into 2022 and for the year, we anticipate improving of that 55% number and working back towards our longer term target, which we've talked a bit about, which is approximately 80% and – which we're not changing that expectation or benchmark.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Got it. And so we should expect sort of year-end leverage 2022 to be, what, around 3 times or so?

Kevin Krumm
Chief Financial Officer & Executive Vice President, APi Group Corp.
A

Yeah. We ended at – or at the close of Chubb, as Jim said and I referenced, we're about 3.9 times. And there's a couple factors that will – depending on how we managed the year, but our expectation is we're going to manage down by approximately 1 time and target towards 2023 to get to that 2 to 2.5 times.

James E. Lillie
Director & Co-Chair, APi Group Corp.
A

Julian, this is Jim. Well, first of all, it was a lovely conference as well. So, I don't want you to feel slighted. But, two, we're going to continue to be opportunistic looking at M&A. And so we can – if we buy right at the right multiple with a company with good healthy M&A or EBITDA, then we can improve our debt-to-EBITDA ratio through M&A. But also, we're going to generate a lot of cash. But as Kevin pointed out, we're going to also be improving revenue through the course of the year, which will eat into cash flow conversion. But we're very bullish on our ability to delever, fund the business; and as Kevin said, we expect, on average, to delever about one turn a year and be back down to our targeted range of 2, 2.5 times over the next three years or so.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

That's helpful, Jim. And so for the year as a whole, just to sort of sum it up, we're looking at adjusted free cash flow conversion maybe in the sort of 70s or 80s percent – or 70s let's say percentage-wise. Is that fair?

James E. Lillie
Director & Co-Chair, APi Group Corp.
A

Directionally. Again, I – we'll see how the year goes, but we're redeploying cash back into the business. Two years ago, I want to say our free cash flow conversion was around 115%, 120%, which was out of the range. Last year, we were under the target of 80%. But on average, as you look at the business over a three- or four-year period, mathematically it'll be about 80% per year.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

That's great. Thanks very much.

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Operator: [Operator Instructions] We'll go now to Kathryn Thompson with Thompson Research. Your line is open.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC

Q

Hi. Good morning, and thank you for taking my questions today, and always fun to have a spicy conference call during earnings season. Following on – I appreciated your commentary on the European situation with no exposure in Ukraine. But pulling the string war and thinking about the unintended consequences or the domino effect that can happen from issues such as this, not only in Europe, but in Asia, how are you thinking about mitigating risk and also thinking about rising cost including fuel? Thank you.

Russell A. Becker
Chief Executive Officer, President & Director, APi Group Corp.

A

Yeah. So, maybe I'll take fuel first. I mean, we have been on top of rising fuel prices in communicating with our businesses nonstop as we've seen some of the inflationary pressure coming forward. And wherever we possibly can, we've been adding fuel surcharges to our invoices, factoring it into our [ph] term (00:45:24) proposals. And, again, Kathryn, I would just point everybody to the small project size that we have. APi's core business, the – our core life safety services business, our average project size is less than $10,000. Chubb's was approximately $2,500. In aggregate, we're at $5,000. So, the quick-hitting nature of the work in the services that we provide allows us to factor all of those rising costs into our proposals and really pass them along.

As we look at risk, our business in Hong Kong, in China is high-performing business. We continue to communicate, and we have a very, very solid leader in that business as well. And we continue to communicate with those individuals and monitor the situation. And what I can tell you is that as we need to, we will adapt and adjust and take corrective action. And so we really are spending a lot of time.

One of the biggest risks in business today is cyber. We have been putting a tremendous amount of effort into our cybersecurity and making sure that our business is really as best you possibly can be in this environment, protecting itself and building the right defenses around the company so that we can stay protected. And it's getting a tremendous amount of attention from, not only our IT leadership, but from Kevin and me and all the way up to – through the board level. So, we are continuing to monitor the business, and we will take corrective action where we need to.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC

Q

Okay. Very helpful. And I appreciate the reclassification of your operating segments. But just a follow-on in terms of kind of your legacy Industrial Services, it's been a lesser portion of your overall business. Is there still rightsizing and trimming of assets that maybe perhaps you're not the best owner? Help us think about just some of those assets as you look forward for planning. Thank you.

Russell A. Becker
Chief Executive Officer, President & Director, APi Group Corp.

A

Yeah. So, first and foremost, we expect in those businesses that were formerly Industrial Services, we expect some bounce-back. In fiscal 2022, we're seeing some of the right types of opportunities as we reposition those businesses from a service perspective. And so we're optimistic that – going forward, that we're not only off the bottom, but we're coming off the bottom and moving upward in the right direction.

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Regarding disposition of any of those assets, I would just say that across the entire book of business that if we need to prune something, we will prune it. And this last year was not the time to prune any of those Industrial Services assets. We will take the time to evaluate that as we move forward through the year and those businesses show improved results. But I would tell you that that holds true for Safety Services and Specialty Services as well. We need to be constantly vigilant in looking at which businesses that we have are going to add to shareholder value.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC

Q

Great. Thank you very much.

Operator: We'll go now to Jon Tanwanteng with CJS Securities. Your line is open.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Hey, guys. Thanks for taking my questions, and congratulations on the nice end to the year. My first one, what are the puts and takes to driving the integration this year with Chubb? And I think if I read your prior press release correctly, the upper and lower bounds of your EBITDA guidance, I guess maybe one of the gating factors there, number one. And then number two, if you could talk a little bit more about the upside opportunity. I think you've been very broadly positive on Chubb. Do you expect to revise the synergy upwards as we go through the year or maybe into next year?

James E. Lillie
Director & Co-Chair, APi Group Corp.

A

Hey, Russ. It's Jim. Would you mind if I just jumped in on this? Because Jon's trying to take your number up.

So, Jon, as many of you guys have heard, and for those that participated in the Barclays and Citi Conference, and as we've talked about pretty openly, Russ and the team did not have great access from a physical presence standpoint to get into the Chubb facilities and meet with the Chubb teams. And so while we did thorough and robust diligence, Blackstone had their perspective on integration. Alvarez and Marsal had their theories on integration.

And so our approach to all of this has been, let's get in there. Let's get our boots on the ground. Let's remove the theories. Let's validate integration, ideas, and concepts. Let's involve the Chubb team along with our team. Let's build an action plan together during the first part of the year. Let's then assign projects to people, assign accountability, put incentive plans in place, and begin executing on those in the back half of the year; but make sure that we have ownership of those plans and we validate them across the entire platform across both sets of teams.

And so we have $20 million built in the plan. You heard Kevin and Russ talk about we see incremental opportunities. But we're going to do this thoughtfully. This is a three-year program to raise margins to 13%-plus. Chubb is part of that. And so we'll be talking about it. But as you also heard Russ say, Chubb is now a brand. We're one company, one team. And so together, we will row the boat forward. But as Russ has also said, this is the center of the fairway transaction. And so the things that are going to – to be the variables are going to be supply chain, inflation, incremental COVID variant and things like that. But that's life.

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Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Understood, Jim. Thank you.

Operator: [Operator Instructions] We'll go now to Andy Wittmann with Baird. Your line is open.

Andrew John Wittmann
Analyst, Robert W. Baird & Co., Inc.

Q

Great. Thanks for taking the questions. I guess maybe for Kevin, I mean, you guys – on the margin improvement initiatives, you guys have done, you've improved the loss-making projects, the customer selection. There's various tech points that you guys have laid out over the years about how margins are going to go up. One of them was about putting new back office systems in, get on the same system, get more efficient that way. And I know that's an ongoing process, so I was hoping you could give us an update as to where you are in that process and when you expect that IT integration to start delivering towards your margin expansion goals.

Kevin Krumm
Chief Financial Officer & Executive Vice President, APi Group Corp.

A

Hi, Andy. Thanks for the question. Yeah. So, as we look at our combined platform with Chubb, so we said last year at our Investor Conference that certainly this was one of the areas that we saw opportunity for leverage and productivity as we move forward here and to drive continued scale across our business. In certain, you referred to as back office functions and/or potentially even procurement in some other areas.

As we went through the back half of this year, we put that on hold, really looking at – wanting to look at Chubb too and look at what we're doing in the context of those Chubb businesses. And so I shouldn't even have said hold. We paused there or slowed it down as we understood what the Chubb transaction needed to look like and the work needed to look like in 2022. As we conclude on our Chubb planning here in the first half of the year, we are going to turn an eye back to that and look at how we can now build out a back office leverage program that includes Chubb in our legacy businesses as we go forward here. So, I don't anticipate seeing anything on that in 2022, but the work will get back underway in the back half of the year. That should help us as we move forward here.

Andrew John Wittmann
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. That's helpful. I guess another one for you. I just – you gave us all the pieces here, walking from EBITDA down to EPS, but just make sure that my math is right. It sounds like in the midpoint, you guys are thinking around $1.32 on adjusted EPS. Is that about right with the assumptions you gave us on the breakdown there, Kevin? Or what's the EPS range that's implicit with this guidance maybe?

Kevin Krumm
Chief Financial Officer & Executive Vice President, APi Group Corp.

A

Yeah. For 2022, yeah, we're at or around $1.32, $1.33 at the midpoint.

Andrew John Wittmann
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Okay. That's all I had. Thanks a lot, guys, for your time.

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Kevin Krumm
Chief Financial Officer & Executive Vice President, APi Group Corp.

A

Thanks, Andy.

Russell A. Becker
Chief Executive Officer, President & Director, APi Group Corp.

A

Thanks, Andy.

Operator: This will conclude our Q&A session. At this time, I'd like to turn it back to Russ Becker for closing remarks.

Russell A. Becker
Chief Executive Officer, President & Director, APi Group Corp.

Yeah. Thank you. In closing, I would first like to start by thanking all of our team members for their efforts in 2021. And I'm particularly proud of the progress that we've made in the midst of all the different challenges that the business faced. So, I'm truly grateful for everyone's hard work and efforts. I'd also like to take the opportunity to thank each of you for joining the call this morning and your continued interest in APi. We truly look forward to updating each of you throughout the year as we continue to cross many, many milestones and drive the business forward.

So, thank you, and have a great rest of your day.

Operator: This does conclude today's program. Thank you for your participation. You may disconnect at any time.

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