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APi Group Corp. (APG)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to APi Group First Quarter 2024 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 Adam Fee, Vice President of Investor Relations at APi Group. Please go ahead.

Adam Fee

Vice President-Investor Relations, APi Group Corp.

Thank you. Good morning, everyone, and thank you for joining our first quarter 2024 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 would 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.

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, May 2, and we undertake no obligation to update any

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forward-looking statements we may make, except as required by law. As a reminder, we have posted a presentation detailing our first quarter financial performance and guidance for our second quarter and full year 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's now my pleasure to turn the call over to Russ.

Russell A. Becker

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

Thank you, Adam. Good morning, everyone. Thank you for taking the time to join our call this morning. Before we provide you with a summary of our first quarter results, I would like to thank our approximately 29,000 leaders for their unwavering commitment to APi. We remain grateful for their hard work and effort. We believe that taking care of our leaders results in our leaders taking care of our customers. This is one of the foundational principles by which we will continue to enhance shareholder value.

Next week marks APi's ninth straight year of celebrating Safety Week. As I have said before, the safety, health and well-being of each of our team members remains our number one value. Our commitment to safety drives industry-leading safety outcomes across the organization. At the end of 2023, our total recordable incident rate or TRIR was below 1.0, which is significantly better than the industry average. We continue to strive for zero incidents. We believe our leadership making APi a safer place to work, along with the investment we make in each of our leaders' development, contributes to our low turnover relative to industry benchmarks.

As we have said before, we remain relentlessly focused on our long term 13/60/80 value creation targets, which include the following. Adjusted EBITDA margin of 13% or more in 2025; long-term organic revenue growth above the industry average; long-term revenues of 60% from inspection, service and monitoring; and finally, long-term adjusted free cash flow conversion of 80%. I routinely speak to our field leaders about how they can help us deliver on this strategy when I'm visiting our locations around the world. Our leaders are aligned with what we want to achieve and how we intend to achieve it.

Turning to the first quarter. In line with our 2024 plan, net revenues were essentially flat, driven by approximately 3% organic growth in service revenues, offset by divestitures, lower revenues from declining material cost pass-through, and intentionally limiting organic growth in certain project-related revenues. Beginning last year and continuing into this year, we continued our planned disciplined customer and project selection in our international HVAC and Specialty businesses. Importantly, we achieved our goal of double digit growth in core inspection revenues in our US Life Safety business. This growth is key as we progress towards our long-term goal of 60% of our total net revenues coming from inspection, service and monitoring.

In line with our strategic initiatives, we continue to see strong improvements in adjusted gross margin for the quarter, up 390 basis points. The strong performance in gross margin led to record first quarter adjusted EBITDA margin of 10.9%, representing margin expansion of 180 basis points. The team continues to make meaningful progress executing our margin expansion initiatives and remains committed to building on that execution as we push towards our 13% or more adjusted EBITDA margin target in 2025. As a reminder, these initiatives include the following, pricing; improved inspection service and monitoring revenue mix; disciplined customer and project selection; Chubb value capture; procurement, systems and scale; accretive M&A and selective business pruning; and as I like to say, we can always just be better.

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On April 15, we entered the complementary and adjacent elevator and escalator services market with the announced acquisition of Elevated Facility Services Group for $570 million. We have long viewed the elevator and escalator service market as an attractive adjacency due to the highly recurring nature of the business driven by non-discretionary, statutorily driven demand. Elevated is expected to contribute approximately $220 million in annualized revenues and approximately 20% adjusted EBITDA margins. We believe Elevated is an excellent platform opportunity for us to enter the $10 billion plus US elevator and escalator services market and execute our bolt-on M&A strategy at attractive multiples. We expect to build $1 billion-plus elevator and escalator services platform over the long term through a combination of strong organic growth, a long-term, cross-sell opportunity with our existing Life Safety businesses, and a robust M&A pipeline.

Elevated's target market, elevator and escalator services, benefits from continuous safety and regulatory requirements. It services an aging installed base with 55% of US vertical transportation units being over 20 years old. Elevated also benefits from an increased demand due to the growth of urbanization, declining durability and quality of elevators, and modernization projects being driven by bringing aged elevators to code and compliance with safety requirements.

The acquisition is expected to be immediately accretive to our 13/60/80 shareholder value creation framework. Elevated's strong organic growth, adjusted EBITDA margin profile of approximately 20%, 70%-plus of revenue from inspection, service and repair, and an asset-light business model driving strong adjusted free cash flow conversion, is a great addition to APi.

In summary, I'm sure you can tell we are excited about Elevated. It has many of the same attractive characteristics as APi and represents a continuation of our focus on building a robust line of businesses that provide mandatorily required life safety service. It benefits from its scale in a highly fragmented market. Its business is driven by regulatory demand and a loyal customer base. It is led by an experienced leadership team and a highly skilled workforce. I intentionally used the word leadership team instead of management team because at APi, we believe that leading and managing are fundamentally different and we aim to build great leaders throughout the organization. Along those lines, Elevated, like APi also maintains an unwavering focus on culture and developing its teammates throughout the organization. We will update full year 2024 guidance to include expected results of Elevated following the close, which we expect to occur late this quarter.

During the first quarter, we also closed on a small divestiture in our Specialty Services segment, which was expected to contribute approximately $20 million in annual revenue. Similar to the divestiture completed in the fourth quarter, this business was highly cyclical and largely focused on lower margin project work in the energy sector. As we move forward, we remain focused on delivering both the 2024 plan and our long term 13/60/80 financial targets. We are excited about our robust pipeline of opportunities for life safety, security and elevator and escalator services businesses, and we'll continue to be thoughtful as we look for high quality margin accretive businesses and leaders to join the APi family.

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

Kevin S. Krumm

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

Thanks, Russ. Good morning, everyone. Reported revenues for the three months ended March 31, 2024 were essentially flat at $1.6 billion compared to $1.61 billion in the prior year period. Organic decline of 1.4% compared to organic growth of approximately 12% in Q1 2023 was driven by disciplined customer and project selection and

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lower revenues from declining material cost pass-through. The result of this was a 6% organic decline in project revenues. This was essentially offset by organic growth of 3% in services revenues.

Adjusted gross margin for the three months ended March 31, 2024 grew to 30.7%, representing a 390 basis point increase compared to the prior year period, driven by price increases, outsized growth in higher margin services revenue, as well as significant margin expansion in project revenues across both segments. Adjusted EBITDA increased by 19% on a fixed currency basis for the three months ended March 31, 2024, with adjusted EBITDA margin coming in at 10.9% representing a 180 basis point increase compared to the prior year period, primarily due to the increase in adjusted gross margins, partially offset by growth investments and the investment in building our global capabilities and infrastructure.

I'm pleased to report that adjusted diluted earnings per share for the first quarter was $0.34 per share, representing a $0.09 per share or 36% increase compared to the prior year period. The increase was partially driven by strong margin expansion in both Safety and Specialty Services and decreased interest expense, partially offset by higher adjusted diluted weighted average shares outstanding.

I'll now discuss our results in more detail for Safety Services. Safety Services reported revenues for the three months ended March 31, 2024, increased by 1.9% to $1.21 billion, compared to $1.19 billion in the prior year period. Organic growth of 0.2% compared to organic growth of 14% in Q1 2023 was driven by 4% growth in services, led by double digit core inspection revenue growth in our US Life Safety business, and 6% organic growth in inspection, services and monitoring in US Life Safety. This was partially offset by an approximately 4% decline in organic revenue from project work, driven by planned customer attrition in our international businesses, as well as disciplined customer and project selection in our HVAC business.

Adjusted gross margin for the three months ended March 31, 2024 was 34.8%, representing a 330 basis point increase compared to the prior year period, driven by price increases, improved business mix in inspection, service and monitoring revenue, as well as significant margin expansion in project revenues. Adjusted EBITDA increased by 18.4% on a fixed currency basis for the three months ended March 31, 2024, and adjusted EBITDA margin was 14.3%, representing a 200 basis point increase compared to the prior year period, primarily due to the increase in adjusted gross margins, partially offset by growth investments.

I will now discuss our results in more detail for Specialty Services segment. Specialty Services reported revenues for the three months ended March 31, 2024 decreased by 9.5% to $389 million, compared to $430 million in the prior year period. Organic revenue declined 7.4%, compared to 4% growth in Q1 2023, driven by a 14% decline in project revenues due to planned, disciplined customer and project selection and lower revenues from declining material cost pass-through. Service revenues were essentially flat. Adjusting for the exiting of one large customer relationship in our infrastructure and utility reporting unit, services revenue would have increased by 11% in the quarter.

Adjusted gross margin for the three months ended March 31, 2024 was 17.7%, representing a 440 basis point increase compared to the prior year period, driven primarily by disciplined customer and project selection, driving significant margin expansion in project and services revenue. Adjusted EBITDA increased by 21.4% for the three months ended March 31, 2024, and adjusted EBITDA margin was 8.7%, representing a 220 basis point increase compared to the prior year period, primarily due to the increase in adjusted gross margins, partially offset by investments to support our service model and increases in certain legal expenses, including those associated with the completed divestiture.

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I'll now discuss cash flows. As we have highlighted in the past, the first quarter is consistently our lowest quarter for free cash flow generation. For the three months ended March 31, 2024, adjusted free cash flow was $12 million, reflecting an adjusted free cash flow conversion of 7% and representing a $12 million improvement compared to the first quarter of 2023. Adjusted free cash flow generation has been and continues to be a priority across APi, and we are pleased we remain on track to achieve our adjusted free cash flow conversion target of approximately 70%.

During the first quarter, and as previously announced, APi reached an agreement with shareholders affiliated with Blackstone Tactical Opportunities Fund and Viking Global Equities to retire all the outstanding shares of their Series B Perpetual Convertible Preferred Stock. Blackstone and Viking each converted all their Series B Preferred Stock into 32.5 million shares of common stock of APi. APi repurchased 16.3 million or one-half of the conversion shares from Blackstone and Viking for an aggregate purchase price of $600 million or $36.90 per share.

The transaction was partially financed by an incremental term facility of $300 million issued at par. On February 28, 2024, we partnered with Blackstone and Viking as they launched a secondary public offering for approximately 12.12 million shares of APi's common stock. As we mentioned before, this transaction simplifies our capital structure, eliminates the $44 million preferred dividend payment, and has no impact on our M&A strategy. At the end of the first quarter, our net leverage ratio was approximately 2.8 times before adjusting for the acquisition of Elevated Facility Services Group announced on April 15 and the second quarter financing activities.

On April 16, we priced a primary follow on offering for 12.65 million shares, raising over $450 million in net proceeds. Earlier this week, we launched a $550 million incremental Term Loan due 2029, with proceeds expected to be used to refinance our $330 million Term Loan due 2026, repay $100 million of outstanding revolver balances, and the remainder for general corporate purposes, including partially funding the acquisition of Elevated.

Following the transaction and financing activity, we remain in a position of balance sheet strength, providing the flexibility to continue to execute our robust M&A pipeline at attractive multiples, with a specific focus on opportunities accretive to our 13/60/80 targets. As we look forward to the rest of 2024, we expect to grow our adjusted free cash flow as well as improve our adjusted free cash flow conversion, providing us a continued opportunity for value enhancing capital deployment, including our planned bolt-on M&A campaign while reducing our net leverage ratio to approximately 2.5 times around year end 2024.

I will now discuss our guidance for the second quarter and full year 2024. We continue to expect full year net revenue to range from $7.05 billion to $7.25 billion, adjusted EBITDA range from $855 million to $905 million, and adjusted free cash flow conversion for the year to be approximately 70%. This guidance has not been adjusted to include the impact from the Elevated acquisition, the divestiture announced this quarter, and headwinds incurred from a strengthening dollar since our initial guidance announced on February 28, 2024.

Based on a current foreign exchange rates, we expect a approximately $35 million headwind on revenue and approximately $5 million headwind on adjusted EBITDA for the full year. As Russ mentioned, we will update our full year guidance following the close of the Elevated acquisition. In addition to adjusting for the contributions of Elevated, we will also incorporate the divestiture announced this quarter and update guidance for the impact of foreign exchange movements on the full year. As we move through the year, we will continue to remain focused on disciplined customer and project selection for Specialty and HVAC businesses. We expect to annualize against the majority of the planned slowdown in certain project work as we cross into the second half of 2024, so allow for strong accelerated growth rates in both businesses in the second half of the year.

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In terms of the second quarter, excluding any impact from the Elevated acquisition, we expect reported net revenues of $1.75 billion to $1.80 billion, reflecting the completed divestiture in Specialty Services and the foreign exchange environment. The guidance represents an organic net revenue growth of approximately flat to 2% up as we lap our strong organic growth of 7.6% in Q2 2023, and as we continue to build a smaller but healthier backlog in our HVAC and Specialty Services businesses.

We also expect to see a continuation of lower material costs, resulting in declining price pass-through versus the second quarter of 2023. This will result in lower projected project revenues. We expect to continue to expand adjusted EBITDA dollars and margin, which is reflected in our second quarter adjusted EBITDA guide of $220 million to $235 million, which represents adjusted EBITDA growth of approximately 9% to 16% on a fixed currency basis, and adjusted EBITDA margin expansion of 140 basis points at the midpoint.

For 2024, excluding any impact from the Elevated acquisition and second quarter financings, we anticipate interest expense to be approximately $150 million, depreciation to be approximately $80 million, capital expenditures to be approximately $95 million, and our adjusted effective tax rate to be approximately 23%. We expect our adjusted diluted weighted average share count for the year to be approximately 279 million, taking into account the Series B transaction and the primary follow on offering of 12.65 million shares executed on April 16.

I'd now like to turn the call back over to Russ.

Russell A. Becker

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

Thanks, Kevin. APi's record first quarter profitability speaks to the effectiveness of our strategy and the alignment in its execution by our global team of leaders. As you've heard from us, we have great confidence in the business and the direction we are heading, despite the volatile macroeconomic environment. The announced acquisition of Elevated and expansion into the adjacent elevator and escalator services market further strengthens APi's competitive moat and expands exposure to statutorily driven demand for our services.

As we look to the years ahead, we believe can create sustainable shareholder value by focusing on our 13/60/80 long-term value creation targets, all of which are accelerated by the announced acquisition of Elevated. These include above industry average organic growth, adjusted EBITDA margin of 13%-plus by 2025, 60% of revenue from service, inspection and monitoring, and adjusted free cash flow of 80%. I am excited about the opportunities for the rest of 2024 and our ability to execute on our strategic plan in the years to come.

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

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QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Your first question comes from the line of Kathryn Thompson of Thompson Research Group. Your line is now open.

Kathryn I. Thompson
Analyst, Thompson Research Group LLC

Q

Hi. Thank you for taking my questions today. APG has focused on the inspection first strategy as you've outlined several times, growing margins through mix and scale. And so, today it's north of 50%. That's up from 40% prior to Chubb. As you enter into a new end market with this elevator end market, how does that fit into the inspection first strategy? And as you go down the road in building out that segment, where do you foresee it contributing to the 60% bogey the company has outlined? Thank you.

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

A

Good morning, Kathryn. Thanks for your support and for participating this morning. So, elevators, just like fire life safety systems are required by law to be inspected for functionality and operability at least annually. And it varies based on state and local jurisdiction. Again, just like fire safety business. If you look at Elevated's business where we take 70%-plus of their business comes from basically inspection, maintenance and repair, that falls right in line with our long-term goal of 60% of our revenue coming from inspection, service and monitoring. That 70%-plus is actually probably higher than that depending upon how you want to slice and dice the modernization work, which is really their version of project-related work.

And a lot of the tuck-in M&A work that we'll do as well as the organic growth that we'll see inside this business comes from the inspection service and repair side of the business. The OEMs will continue to focus on the installation side, new construction side, where the independent providers are more focused on the service and repair component of it. So this fits right down the center of the fairway for us as it relates to continuing to focus on growing that piece and component of the business. And we're super excited about the Elevated team. We're also super excited about the opportunity for us to really grow in the space.

Kathryn I. Thompson
Analyst, Thompson Research Group LLC

Q

Thanks. And then just a follow-up question, there's been a fair amount of simplifying the capital structure in the quarter. Congratulations on that. But just to reiterate, does this change at all your capital priorities? And in particular, does it have any impact on your M&A initiatives that you've outlined previously?

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

A

Hi, Kathryn. This is Kevin. I would say, in short, no. Our priority as we came into the year was to continue to focus a good portion of our free cash flow on stepping up our bolt-on and tuck-in M&A campaign. That is still the plan. We also had planned to pay down some debt later in the year and nothing has changed there either. So our plan as we started the year and our priorities remains the same.

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Kathryn I. Thompson
Analyst, Thompson Research Group LLC

Q

Perfect. Thank you very much.

Operator: Your next question comes from the line of Andy Kaplowitz of Citi. Your line is now open.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Good morning, everyone.

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

A

Hey, Andy. How are you?

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Good. How are you? Russ, can you give us a little more color into core safety markets? Obviously, you continue to focus on project selection, but implied in your 2024 guidance continues to be a relatively significant step up in organic growth in the second half. So what's your visibility at this point to step up? Is it really just the comp on increased project selectivity really starts in the second half? And are there any key verticals that you expect to drive the growth, such as data centers?

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

A

Well, clearly data centers. So, I mean, the answer is we have really good visibility. We're building backlog as we speak, and we're building really good healthy backlog as we speak. Data centers is contributing both in our Safety Services segment as well as our Specialty Services segment. So, and we also see strong wins in the semiconductor space. So, I mean, I don't think that anything has changed as it relates to the end markets that our business leaders are focused on today. And we're still leading with inspections, but the project-related work that we're bringing on to our books is all good, healthy work in healthcare, data centers, semiconductors, advanced manufacturing are all the right places for us to play.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Appreciate that color. And then, Russ, maybe a little bit more color into the Elevated growth profile. I know you said it would deliver $220 million annually of revenue, but what should the growth look like over the next couple of years? And maybe versus that base, should it be accretive to APG's growth or similar? And then how do you think about the synergy under cross selling opportunities versus your core Life Safety business?

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

A

Yeah. So I mean, organically the business is growing high single digits and we don't see any reason for that to change. Obviously we would like to continue to accelerate that if we possibly can. We see a really strong opportunity for us in the bolt-on M&A space. It's very similar, highly fragmented market, just like the fire life safety

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spaces. So we see some opportunity there for, so to speak, non-organic growth to continue to complement that business.

In the cross-selling opportunity, we actually had some – we actually had the Elevated team on campus yesterday. And really, even though the transaction is not scheduled to close until later on in the quarter, but started conversations around what integration looks like and had some conversation around cross-selling and how we can potentially align branch offices and branch locations. And the best way for us to do that is to get people sitting next to each other. And that obviously is going to take a little bit of time for us to sort that out where we've got a good idea and we got good view into where we have overlap, so to speak, from a branch perspective.

But getting that real estate footprint mapped out and consolidated is going to take a little bit of time for us to do that. But the more our business leaders get to know each other and really develop relationships, the easier and the faster you can facilitate cross-selling opportunities. But the Elevated team met with our business leader from our national accounts group yesterday to kick that process off. And so, that's a journey and it's going to take some time. But we feel really good. I mean, everybody's attitude is kind of in the right place, and everybody is thinking about the same way. I mean, there's going to be some opportunities for us to take advantage of their customer relationships, and that's something that we're excited about.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Appreciate the color, Russ.

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

A

Thanks, Andy.

Operator: Your next question comes from the line of Andy Wittmann of Baird. Your line is now open.

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

Q

Yeah. Thanks for taking my question. I guess, I wanted to ask about the services growth. I think you mentioned on the prepared remarks that it was 3% in the quarter. You also mentioned that the US inspection business is growing double digit. So I guess, Russ or Kevin, could you just decompose a little bit and give some color behind the 3% growth rate? Were there larger customer exits in the international business perhaps that held that back? Because it feels like US business is doing pretty well, but 3% is okay. But I mean, over time, certainly your expectations are higher than that.

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

A

Hey, Andy. This is Kevin. I'll take a shot at that first. The 3% number was total APi growth on services. So that includes Specialty, also includes services on the HVAC side of the business. I referenced in my commentary, I believe, the fact that in Specialty we walked away from a significant customer that wasn't willing to take the price increase. That was largely a service contract. So in that number, that's going to be a drag.

Similarly, on the HVAC side of the business, as we continue to think through those customer sets and those end markets, our service revenue was also down on HVAC. If you pull those two and set them aside, our service

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growth was actually, on the rest of the business, was north of 6%, I believe. And so, really, that inspection on sort of the core life safety is still driving sort of the pull through on service.

The only other thing I'll say there is, generally, we do have other service type of work. And in the quarter last year, in US life safety predominantly, we saw a significant amount of work related to freezes, sort of the freeze up that was happening in North America. And so, we're comping against that. But underlying, our service business, where we want it to grow continues to grow well and is still, especially in North America where we track it versus inspections, is still highly correlated to that 10% or that double digit growth Russ referenced.

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

Q

Okay. That's super helpful. I just thought maybe as a follow-up you could just talk a little bit about what you're seeing out of your international life safety business, in particular. Are you seeing growth in pricing and how the economy in Europe and the parts of Asia where you compete holding up to support your expansion there?

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

A

Yeah. So the international business grew modestly in the first quarter, so again, we continue to see organic growth on a quarter by quarter basis since we've owned the business. Coming off a tough comp, I think they had organic growth in the first quarter of last year at 11% or 10% or something like that, Andy. So, but we did grow modestly in the first quarter this year. And in general, the business continues to hold up as we continue to kind of focus on a couple of fronts, really focusing on the right end markets. And I think the team is focused on the right end markets. I don't know if I could have said that to you two years ago, but I think today, the team is focused on the right end markets.

And we're going through really kind of a sales force transformation. I don't know if that's the right word, but we're really – we have a new sales leader in our international business and he is going through an effort to kind of bring that same inspection and service mindset, selling that first. It's a little bit of a different market over there, but just even taking the concept of we're going to sell inspection and service first into the already built environment takes a mind shift change. And so we're going through that with that sales force.

But our backlog in our international business is basically sitting like right on top of where it was a year ago, plus or minus. And we've seen some customer attrition as we continue to take price and make sure that we're making smart decisions about where we're deploying our most important resource, and that's our people. So I feel really good about where the business is at, and really, the momentum that they continue to gain as they go through their value capture efforts.

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

Q

Thank you very much.

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

A

Thank you, Andy.

Operator: Your next question comes from the line of Julian Mitchell of Barclays. Your line is now open.

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Q

Hi, good morning. This is [indiscernible] (00:38:14) on for Julian Mitchell. How is the M&A pipeline overall? You did Elevated, could we expect active M&A over the rest of 2024? And how is the environment in terms of valuations?

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

A

M&A market, our pipeline is really good, strong, robust. I would tell you that for us, we need to continue to focus on the right stuff as we're looking at the M&A market, and it needs to be complementary to our existing offerings, whether that's geographically or the types of services that the business provides. It needs to be complementary to our margin expansion goals, and either that or we have to see a clear path to the business being complementary to our margin expansion goals. And the leadership and the team needs to align from a culture values and fit perspective, and that doesn't – whether that's in Elevated or a small family-owned business in Paducah, Kentucky.

And we need to continue to be disciplined as we look at it. There are many good opportunities and our team is doing a fantastic job. I'd say an amazing job of vetting those opportunities. And you'll continue to see us make significant progress. I think we spent roughly $100 million on bolt-on M&A over the course of the last year. And we've said that it's our intent to accelerate that. And we feel that, with the flexibility we have with our balance sheet, even with doing the elevated acquisition, we still have the flexibility to accelerate that bolt-on, tuck-in strategy.

Q

Got it. Thank you. And a quick follow-up. Gross margins are showing a decent increase, how is APG coping so well with wage inflation among its service technicians?

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

A

So, hey. This is Kevin. I'll take that. At the end of the day, we've been on a pricing campaign for the last decade. And we say consistently that we look to take margin expansive pricing on the service side of the business. Our businesses do a really good job of staying in front of that and continue to price for all elements on the service side that we need to price through, of which labor is one. So, I would say, it's a muscle our teams develop and they continue to work and flex it annually.

Q

That's helpful. Thank you.

Operator: Your next question comes from the line of Stephanie Moore of Jefferies. Your line is now open.

Stephanie Moore
Analyst, Jefferies LLC

Q

Hi. Good morning. Thank you.

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

A

Hi, Stephanie. Good morning.

Stephanie Moore
Analyst, Jefferies LLC

Q

Hi. What are the – good morning. I wanted to follow up actually on the prior question, so maybe to take that a step further. Is it possible for you to kind of frame your ongoing M&A strategy, and then also, how that matches with the recent equity raise? So, how should we infer that with your appetite to do larger deals going forward, even after Elevated? And then is there a potential to expand again outside of the legacy fire and safety and the now Elevated verticals? So an update there would be great. Thank you.

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

A

Yeah. I don't think you're going to see us – I'm going to answer the latter half of your question first, Stephanie, and then Kevin can add any color that he'd like around our balance sheet and the flexibility we have there. But I mean, I don't think you're going to see us strayed outside really of the most recent adjacency, the elevator and escalator space. I mean, we're kind of a – I don't know, we're going to show the Street and our investors and folks that we've got the capability to execute in this space before we really get too curious about straying outside of, say, the fire life safety, security and now the elevator and escalator space.

And I think as part of our – we've always been pretty disciplined from that standpoint. I think we need to stay disciplined and execute inside this new vertical that we brought into the APi family. And I think we will show you that we have the capability and the capacity to do that. And we've got some interesting opportunities that we're looking at. Nothing that I would say – I'd say we've got some opportunities that we're looking at that are, so to speak, bigger than a tuck-in, but we're not looking at anything that is, I don't know, Chubb-esque. I don't know if that's the right way to put it or not put it, but we're – so we've got some things that – we have $100-plus-million revenue business in the fire life safety space that we're looking at. And that would be interesting and a good fit that wouldn't increase our leverage, I mean.

So, we have really good flexibility. I mean, with everything that we've – the moves and the decisions that we've made around our balance sheet, and with the equity raise and even the Series B and now with the Term Loan, I think just gives us just great flexibility and optionality to just continue to take advantage of the opportunities as they present themselves. And we're going to be smart, we're going to be disciplined, and we're going to make good choices for the business long term. Kevin, do you want to add any color?

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

A

No. I think just a little bit. Russ said it well. When we think about M&A, there's sort of both bolt-on and there's that mid-low platform and then there's the larger ones like Chubb. As we finance these, we actually are looking forward to make sure that we remain nimble enough to do what we need to do over the next 12 months. And I think you said it well, if there is something out there, we can fund bolt-on, tuck-in through ongoing cash flows, anything in that mid-level, we'll flex up. We have the balance sheet to do it pretty easily and I think we have the sort of history to pay that down and to get back into our targeted levels pretty quickly. And that's kind of how we're going to manage things that allow us to be as opportunistic as possible.

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Stephanie Moore
Analyst, Jefferies LLC

Q

Understood. Thank you. And then, just as a follow up, and again, congratulations on the Elevated deal. It does seem to be a fantastic fit here. I wanted to ask on the maybe medium to long-term cross-selling opportunities of this business. If you could talk a little bit about the sales force within Elevated, and then the ability over time to kind of cross-sell opportunities from the legacy, your legacy fire and safety side, and then obviously on the elevator services too. Again, thank you.

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

A

Yeah. So, I mean, again, the cross-selling opportunity is real. It is significant. And I would say we've taken one step – even though the transaction hasn't closed, we've taken one step forward by just introducing sales leaders and getting people acquainted with each other. My experience tells me that this will take a little bit of time for us to really execute on this cross-selling strategy. And it's funny because you want your people to open up their customer relationships to their peers, and if they really don't know their peer and they really don't trust their peer, it's more difficult for them to open up that customer relationship.

And so, it's easy for me to say, we should do this or you should do this or anything like that, but the more we bring our branch operations together and cohabitate, the faster we'll be able to achieve really momentum as it relates to cross-selling. Do I think that a sales leader in our business can walk into a customer and sell fire life safety inspections and sell elevator inspections? I do. And I think that there's the opportunity for us to educate our sales force. But that's going to take some energy and effort and for us to really kind of develop a plan here over the next couple of months as we work towards getting the transaction closed.

I've got a great – we have a really great real life example, that in Omaha, Nebraska, in our branch office, we have a fire life safety business that cohabitate space with one of our Specialty Services business. And each of those branches has like absolutely thrived by kind of living in the same quarters. And they drag each other to the same customer sites and like, hey, we've got customer ABC and do you guys do any work for them? And no, come with me, and it's really – it's accelerated because of this idea that they're in the same space and living under the same roof. And that's really the work that we need our real estate people to start working with the leaders of our life safety businesses and in Elevated's business to execute on that.

And there's a total willingness to do it. We also think that there's an opportunity, especially in the Elevated case to basically organically open up shops in some of the branches that we have existing footprints already. So, but it's going to take some effort and it's not going to happen overnight. And so we have to just – I want to make sure that we're being realistic about setting expectations with everyone about the energy it's going to take for us to really execute on that.

Stephanie Moore
Analyst, Jefferies LLC

Q

Great. Thank you so much.

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

A

Thanks, Stephanie.

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Operator: Your next question comes from the line of Jon Tanwanteng of CJS Securities. Your line is now open.

Jon Tanwanteng
Analyst, CJS Securities, Inc.

Q

Hi. Thank you for taking my questions. I was wondering if you could drill down into the elevator and escalator market a little bit more and the longer term potential there for acquisitions. Do the assets there come up for sale frequently? Are the multiples similar to the ones you've seen in your core business? Are the margins and business models more similar to what you see at ESF or is that more of a unique asset? Any more color there would be appreciated.

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

A

I think it's very, very similar to the fire life safety and security space, Jon. And I should say good morning and thank you for participating before I get carried away here. But I think it's like textbook, and I think the multiples are going to be similar. I think the sellers are going to be looking for the right home for their business just like how we've executed in the fire life safety space. It's just as fragmented as a fire life safety and security space.

So, like, I think that other than you got to brush it off and call it an elevator versus a fire alarm, I think it's the same. And so I think from an M&A perspective, we'll be able to run. And there's boutique brokers/bankers in the space, but the reality of it is, especially just talking to the team yesterday, is that they know the market, they know the players in the market, they know who is aligned culturally with us, and I think that that's something that we'll be able to take advantage of those relationships. Like, every one of the senior leaders on the Elevated team has come from the elevator and escalator space, so they know the market very, very well.

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

A

Yeah. The only thing I would add is, the market, the makeup is the same, highly fragmented. They're market leader in a lot of the markets they play in, still in that 5% range. There's a couple where there may be 10%, but outside of that, it's highly fragmented. And they come to us with a robust pipeline and targets.

Jon Tanwanteng
Analyst, CJS Securities, Inc.

Q

Got it. Thank you. And then I was wondering if you could just talk about your second half expectations in the core business. I know you haven't formally updated your guidance, but you did perform well on Q1. Your Q2 guidance on an earnings level looks strong. I'm just wondering, we should expect upside just for the organic core business when you do formally update your guidance for all the factors you mentioned before?

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

A

Well, just on guidance, I'll say, the Elevated – and then I'll talk about the back half, but I'll try and tackle guidance here too, Jon. And I appreciate the question. We've sort of been in this nontraditional spot where we have a material acquisition we're looking to close here on May 2. As we said, we're looking to close it in the quarter and we believe it to be sort of a material update for the year. We also have a history of rolling FX through, but noting we're close to closing that transaction, we want to take our time and bring that in and work with that team to better understand what their back half of the year looks like. And so, we intend to do that and we'll bring in sort of the FX element.

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But the other thing we're trying to say in this guide that we communicated today is there should be no significant changes on the base business as we look at the back half of the year beyond Q2. And when you look at the back half of the year, we're expecting to see accelerated organic growth. Our service business, our service growth rate where we want them to have held up in the first half of the year. We expect that to continue in the back half of the year, and then we expect the businesses that have been going through – so that would be HVAC, the project business in Specialty, the project business on the international side, to annualize against the great work those teams have been doing to start to show sort of low to mid-single digit growth on the projects side. The two of those together are sort of what's delivering that 6% to 7% organic in the back half of the year.

Jon Tanwanteng
Analyst, CJS Securities, Inc.

Q

Got it. That's helpful. Thank you.

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

A

So, Jon, Stephanie, everybody, I'm going to just add a bullet point about this whole cross-selling. So, the other night, I mentioned the Elevated team was on campus yesterday and we had a dinner with them the previous evening. And we invited one of our local business leaders to attend that dinner. And while we were sitting here and during the course of the call, he sent me a note, and it read something to the point about getting leaders together from the earnings call this morning. I had a chance to connect with many of the Elevated leaders at dinner Tuesday. As the first bullet being fired, we invited, Ben, who is the regional VP for Elevated out of Indianapolis, to join our Service Leaders' Summit in Columbus, Ohio this June.

So, I mean, there's already work going on where we're getting people kind of cross-pollinated. And I mean, that's one of the beauties of our business and this focus on leadership development and investment in people, like our business leaders are generally curious people and they want to – these newly acquired companies, they surround them and bring them warmly into the business. And this is just a good example of how this whole idea of cross-selling and sharing opportunities and knowledge and everything else is going to come to fruition. So hopefully that's helpful color.

Operator: Your next question comes from the line of Steve Tusa of JPMorgan. Your line is open.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Hey, good morning.

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

A

Hey. Good morning.

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

A

Good morning.

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

A

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How are you?

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Congrats on the margin execution, really strong.

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

A

Thank you.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Just on kind of the trajectory for the second half on the sales side. I know you guys used to talk about like backlog and kind of some forward indicators on some of the businesses. How should we think about things as they move forward in the base business for the third and the fourth? You mentioned I think the 6% to 7% in the back half. And I think the comps kind of stabilized a bit in the back half. But is that a steady trajectory? Is it pretty consistent, the growth 3Q and 4Q? And then, in that context, like, it's hard to tell what normal seasonality actually is. You had a nice sequential step up – or you have a nice sequential step up from 1Q to 2Q, how does that typically behave seasonally, 3Q and 4Q, with these businesses?

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

A

Hey, Steve. This is Kevin. I'll take a stab at this and then Russ can add anything that makes sense after. I would say, when you look at the back half of the year, backlog in our US Life Safety business, and then he talked a little bit about backlog in our international business, that has held up and continue to become healthier. And frankly, on the US Life Safety side, we've continued to add to it. So we feel really good on the safety side about the backlog as we head into the back half of the year. And so that's reflected. And I said earlier – so that drives projects work as you may know or I think as you know. And so, and I said earlier, on the service side of the business, those businesses have continued to perform very well and as expected in the first half of the year and we expect that to continue in the back half of the year as well.

Where we've been shrinking the backlog and getting, I'll say, a smaller but healthier backlog is in the HVAC business and the Specialty business. And what you'll see in those businesses in the back half of the year as well will be that we should see a return to growth. It'll be low single digits, but we should see a return to growth in those businesses as well in the back half of the year and sort of the combination of all of that. We don't guide at a segment level, but the combination of all that really is what's driving that improvement in the back half of the year.

You asked about seasonality, that obviously doesn't impact growth rates so much, but just more sort of volumes. What we generally see in our business, because it's predominantly a northern hemisphere business and some of the work we do or a lot of the work we do is outside, especially in Specialty, is our two largest quarters from a revenue standpoint in any given year is going to be the second quarter and the third quarter, that's going to drive sort of growth on a fixed cost base. So those are generally going to be our two largest margin performing quarters as well. And then off of Q3, we usually step down sequentially into the fourth quarter, a lot of it weather related.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

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Yeah. That makes sense. And then just one last one. How is – I would assume if you're disciplined on these projects that price is holding up relatively well. I'm not sure if you touched on it on an earlier question, but any color on like in the – I know price in terms of like flat organic maybe not be that relevant of kind of small numbers, but in the back half for you, are you counting on any price running through?

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

A

Yeah. Absolutely. So we think about price the following way, we have pricing that we push through on the service side of the business. We expect that to be margin enhancing as it relates to services. I would say in the first half of the year, roughly that price number has been around 3% on our ongoing or recurring service revenue stream. We expect that to continue in the back half of the year.

With respect to projects, we look at that sort of more as price pass-through. We don't anticipate that being a significant driver because we should annualize through that in these summer months, which is really where we started to see pricing come down last year. So we should be through it in the back half of the year. There shouldn't be significant impact on our growth rates, positive or negative, from the price pass-through.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Great. Great color. Congrats on the execution and congrats on the deal as well. Thanks.

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

A

Thanks, Steve.

Operator: Your next question comes from the line of Ashish Sabadra of RBC. Your line is open.

David Paige
Analyst, RBC Capital Markets LLC

Q

Hi, good morning. This is David Paige on for Ashish. Thanks for taking my question. I just had a quick follow-up on the pruning or the project selection. How much more of that do you feel like you need to do until the business or the customer base is, I guess, where you want them to be ultimately? And then, one more on just following up on the price or the price cost. Looks like I think you mentioned that raw material costs or commodity costs are going to be lower, what's the tailwind there for the year? Thank you.

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

A

I will answer the last part first, which was on the price pass-through. We don't expect there to be much of a headwind or tailwind as it relates to our organic growth rates from pricing through. And I would say generally, on the project side of the business, we're really just trying to accommodate sort of the material cost runoff and pass it through. So, we don't think it's going to impact our growth rates and it shouldn't be a tailwind, if you will, on margins either.

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

A

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I can handle the pruning component of your question. I would tell you that, for the most part the pruning work from a customer selection perspective will, number one, will never stop. But some of the real disciplined pruning that especially that you're seeing in our Specialty and HVAC businesses, really is Kevin's earlier remarks is really kind of we'll continue through the second quarter and you'll see that backlog become healthier in that kind of component of it going back to more of a growth mode. You'll see that in the second half of the year.

Internationally, it'll probably continue more through the end of this year from some of our customers and a lot of that has to do with the fact that we had some three-year contracts that we had to honor, if you will. And this would be like really the third year that we've owned the business and it'll take us through that period of time to prune some of those. And we've been dealing with those, some of those customer contracts, but we do have some legacy contracts there that we're still dealing with, that some of that will carry through at the end of the year and should be cleaned up into 2025.

David Paige
Analyst, RBC Capital Markets LLC

Q

Appreciate it.

Operator: That concludes our Q&A session. I will now turn the conference back over to Russ Becker for the closing remarks.

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

Thank you. I appreciate that. In closing, I would like to thank all of our team members for their continued support and dedication to our business. We believe our leaders are the foundation on which everything else is built and that the safety, health and wellbeing of each of our leaders remains our number one value. I would also like to thank our long-term shareholders, as well as those that have recently joined us for their support. We appreciate your investment in APi and we look forward to updating you on our progress throughout the remainder the year.

Thank you everybody for joining our call this morning, and we look forward to continuing to keep you abreast of the positive things that are going on in the company.

Operator: That concludes today's call. Thank you all for joining. You may now disconnect.

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