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APi Group Corp. (APG)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the APi Group's Second Quarter 2024 Financial Results Conference Call. All participants are now in a listen-only mode until the question-and-answer session. Please note that 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 second 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.

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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, August 1, and we undertake no obligation to update any forward-looking statements we may make except as required by law. As a reminder, we have posted a presentation detailing our second quarter financial performance on the Investor Relations page of our website. Our comments today will also include non-GAAP financial measures and other operating key 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 getting into the results, I wanted to thank our 29,000 leaders for their hard work and dedication to APi. The safety, health and well-being of each of our leaders remains our number one value. We continue to prioritize investing in the men and women in the field as human beings and aim to provide each of them with training, leadership development and advancement opportunities.

At APi, our field leaders have careers, not just a job. We prioritize this investment because we recognize that our success happens only when our branches and field leaders are successful. This commitment is one of the foundational principles we believe will continue to enhance shareholder value.

We remain committed to our long-term 13/60/80 value creation targets. We believe these will lead to outsized investor returns through 2025 and beyond. As a reminder, these 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 long-term adjusted free cash flow conversion of 80%. As I mention often with both investors and our team, we are relentlessly focused on driving this strategy with a specific focus of achieving 13% plus adjusted EBITDA margins by 2025, which we remain confident in achieving.

To be clear, we view 13% as our next checkpoint, not the ending destination in a long-term margin expansion journey. As we move closer to the achievement of this goal, we expect to plan an investor update on our new targets and opportunities in early 2025.

During today's call, I will begin my remarks by briefly commenting on our second quarter results, as well as our continued progress towards delivering on our stated strategic goals in a macro environment that continues to be volatile. I will then touch on our recent M&A activity and our focus on long-term organic growth before turning the call over to Kevin, who will walk through our financial results and guidance in more detail.

Turning to the second quarter. APi delivered strong results by executing our strategy focused on margin expansion and free cash flow generation. We achieved record second quarter adjusted EBITDA dollars and margin as well as record adjusted free cash flow dollars and conversion in an evolving macro environment.

Net revenues declined by approximately 2% in the quarter compared to 7% plus growth in the prior year period. As we have discussed over the past year, we have been strategically slowing revenue growth to focus on more profitable projects. The team has done an excellent job with this initiative, particularly in our international HVAC and Specialty Services businesses. This quarter, a combination of federal funding, permitting and some customer delays contributed to the reduction in project revenue. We believe these delays are temporary timing shifts, not

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cancellations, and we expect the impacted revenue to still contribute to our full year 2024 revenue in a meaningful way.

With nearly all of the planned revenue slowing and project delays behind us, our teams are focused on healthy organic growth in the back half of this year and in 2025. I said before that backlog would not be a great indicator of the momentum in our business while we double down on our disciplined customer and project selection initiative. And while we don't plan to provide backlog commentary on a regular basis, I wanted to share that at the end of the second quarter, our backlog was up $500 million versus the end of the year and much healthier from an expected profitability perspective. The work the team has done in transforming our backlog and re-accelerating its growth gives me confidence in the direction we are heading as a business.

I am pleased to report that US Life Safety once again led the way from a growth perspective where we had a record quarter of inspection revenue, driven by continued double-digit organic growth, which we have achieved for 16 straight quarters. This is critical as these inspection revenues drive recurring higher margin service revenues and help APi make progress towards our 60% target for inspection, service and monitoring revenues.

In line with our strategic initiatives, we continue to see strong year-over-year improvements in adjusted gross margin and adjusted EBITDA margin in the second quarter, up 340 and 190 basis points respectively. I am pleased with the leadership team's ongoing commitment to driving gross margin improvements through 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.

The international Life Safety business continues to show steady progress with another quarter of organic growth, which that business has achieved in each quarter since the acquisition even as we challenged the team to be intentional about targeting only work that is additive to achieving our 2025 adjusted EBITDA margin targets. Additionally, the $125 million value capture plan, which is another key contributor to our 13% or more target, remains on track. During the second quarter, we crossed the 50% mark in terms of realizing the savings from our $125 million value capture target and have taken actions associated with approximately $90 million of run rate savings.

APi's consistently strong financial results speak to the direction we are heading in and the strength of the company's recurring revenue services-focused business model, as well as the discipline of the organization and its leadership team.

Moving on to M&A. We closed on the acquisition of Elevated Facility Services in early June, and it has been rewarding, welcoming the team to APi. We remain excited for the opportunity to build onto the Elevated platform and become a leader in the elevator and escalator service market. In addition to Elevated, our bolt-on M&A strategy continues to progress. Through the second quarter, we have closed six bolt-on acquisitions with an average EBITDA multiple of approximately 5 times. The markets we operate in are highly fragmented and the team remains focused on identifying the most attractive opportunities within our robust M&A pipeline.

Our free cash flow generation and EBITDA growth in the first half of the year gives us confidence in our ability to reduce net leverage below our target of approximately 2.5 times by the end of the year while we continue to execute our M&A strategy. With expected adjusted free cash flow of over $600 million in 2024, we remain committed to our capital allocation priorities, which remain as follows: deleveraging to our net leverage target of 2.5 times adjusted EBITDA; growing our business through executing our M&A strategy; and finally, repurchasing our shares.

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As an update and reflective of the share repurchase activity undertaken in the first six months of 2024, APi has approximately $400 million remaining under our share repurchase authorization of the $1 billion authorization from February of 2024.

In summary, while we remain focused on building on the execution of our strategy in the back half of the year, I'm proud of our team and how we delivered on our commitments and produced record EBITDA and free cash flow so far in 2024.

I would now like to hand the call over to Kevin to discuss our 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 June 30, 2024 were $1.73 billion, a decline of 2.3% from $1.77 billion in the prior year period. Organic decline of 3.1% against a comparison of 7.6% growth in Q2 2023 was driven by disciplined customer and project selection and project delays in our Specialty segment. The result of this was a 9% organic decline in project revenues. This was partially offset by organic growth of 2.4% in services revenue. Adjusted gross margin for the three months ended June 30, 2024 grew to 31.7%, representing a 340-basis point increase compared to the prior year period, driven by price increases, outsized growth and higher margin services revenue, as well as a significant margin expansion in both service and project revenues across both segments.

Adjusted EBITDA increased by 13.8% for the three months ended June 30, 2024, with adjusted EBITDA margin coming in at 13.4%, representing a 190-basis point increase compared to the prior year period, primarily due to the increase in adjusted gross margins, partially offset by lower fixed cost absorption driven by lower revenues. Adjusted diluted earnings per share for the second quarter was $0.49 per share, representing an $0.08 per share or 20% increase compared to the prior year period. The increase was driven by strong margin expansion in Safety Services and decreased interest expense, partially offset by higher adjusted diluted weighted average shares outstanding.

I will now discuss our results in more detail for Safety Services. Safety Services reported revenues for the three months ended June 30, 2024 increased by 4.4% to $1.28 billion compared to $1.23 billion in the prior year period. Organic growth of 1.5% compared to organic growth of 7.3% in Q2 2023 was driven by strength in US Life Safety, where we once again posted double-digit inspection growth and 8% organic growth in inspection service and monitoring revenues. This was partially offset by a double-digit decline in HVAC revenues driven by disciplined customer and project selection and by planned customer attrition in our international business.

Adjusted gross margins for the three months ended June 30, 2024 was 35.3%, representing a 290 basis point increase compared to the prior year period, driven by price increases, improved business mix of inspection, service and monitoring revenue, as well as significant margin expansion in both service and project revenues. Adjusted EBITDA increased by 26.4% for the three months ended June 30, 2024 and adjusted EBITDA margin was 15.7%, representing a 270 basis point increase compared to the prior year period. This was primarily due to the increase in adjusted gross margins and was partially offset by headwinds from operating costs, which grew faster than revenues.

I will now discuss our results in more detail for Specialty Services. Specialty Services reported revenues for the three months ended June 30, 2024 decreased by 18.4% to $453 million, compared to $555 million in the prior year period. Organic revenue declined 15.3% against the comparison of 7% growth in Q2 2023, driven by a 21%

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decline in project revenues due to our ongoing efforts regarding disciplined project selection, as well as a combination of federal funding delays, permitting delays and customer delays. Service revenues were down 10% due to the exited customer relationship discussed last quarter. Adjusted for this customer, service revenues were essentially flat in the quarter.

Adjusted gross margins for the three months ended June 30, 2024 was 21.4%, representing a 230 basis point increase compared to the prior year period, driven by disciplined customer and project selection driving solid margin expansion in project and service revenues. Adjusted EBITDA decreased by 10.1% for the three months ended June 30, 2024, due to lower revenues and adjusted EBITDA margin was 13.7%, representing a 130 basis point increase compared to the prior year period, primarily due to the increase in adjusted gross margins, partially offset by lower fixed cost absorption.

I'll now touch on cash flows. We continue to focus on driving free cash flow conversion improvements year-over-year and I'm pleased with the progress to date in 2024. For the three months ended June 30, 2024, adjusted free cash flow came in at $122 million, reflecting an improvement of $31 million versus the prior year and adjusted free cash flow conversion of 53%. For the first six months of the year, we increased adjusted free cash flow conversion by $43 million compared to the prior year period. Free cash flow generation has been and continues to be a priority across all of APi and our performance in the first half of the year positions us well to deliver on our 2024 guidance of approximately 70% adjusted free cash flow conversion, representing an adjusted free cash flow delivery of over $600 million at the midpoint of our updated adjusted EBITDA guide.

At the end of Q2, our net debt to adjusted EBITDA ratio was approximately 2.7 times, taking into account the Elevated acquisition and second quarter financing activities. As a reminder, the back half of the calendar year is seasonally our strongest adjusted free cash flow generation, and we expect that trend to continue this year with second half free cash flow allowing us to continue to deleveraging to below our stated long- term net leverage target of 2.5 times by year-end.

I will now discuss our guidance for Q3 and full year 2024. We continue to expect full year reported net revenues of $7.15 billion to $7.35 billion at current currency expectations. With the pushout of certain projects driven by funding, permitting and other related delays, as discussed by Russ, our current view is that the full year revenue will be closer to the low end of our guidance. Having said that, we remain confident in the margin profile and performance of the business, which is why we have brought up the bottom end of our adjusted EBITDA range by $10 million. This is reflected in our narrowed full year adjusted EBITDA guide of $855 million (sic) [$885 million] to $915 million and represents adjusted EBITDA growth of approximately 13% to 17% on a fixed currency basis.

In terms of Q3, we expect reported net revenues of $1.86 billion to $1.91 billion. The guidance represents reported net revenue growth of 4% to 7% and organic net revenue growth of 2% to 5%. We expect Q3 adjusted EBITDA of $240 million to $250 million, which represents adjusted EBITDA growth of approximately 7% to 12% on a fixed currency basis. For 2024, we anticipate full year interest expense to be approximately $145 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 average share count for the year to be approximately $279 million.

Overall, we are pleased with the team's execution of our strategy in an evolving macro environment during the second quarter and first half of 2024. I look forward to sharing more updates on our progress as we move throughout the year. I'll now turn the call back over to Russ.

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

Thanks, Kevin. As you've heard, APi delivered strong financial results in the second quarter and first half of the year. The business continues to perform well with record adjusted EBITDA margin and free cash flow generation. I'm confident in our leaders' ability to generate continued momentum in the business built on historically strong execution, consistently drive margin expansion and return to historical levels of organic growth in the back half of the year and into 2025. We believe we can create sustainable shareholder value by focusing on our 13/60/80 long-term value creation targets, and we feel confident in our ability to achieve our 13% or more adjusted EBITDA margin target in 2025.

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

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. Please go ahead.

Kathryn I. Thompson
Analyst, Thompson Research Group LLC

Q

Hi. Thank you for taking my questions today. And just to get kicked off, you discussed project delays impacting the top line for the quarter. Is feedback in the field from [indiscernible] (00:20:59) contacts has been that projects are seeing some delays but not cancellations? Could you give more color on whether these projects are just delays or cancellations? In addition, could you discuss what you're seeing in the back half of the year? Essentially, what gives you confidence for that full year guidance? Thank you.

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

A

Thanks, Kathryn, and thank you for your continued support. It's a great question. And I just, I want to start by level setting with everyone that we are not a projects-first company and we are focused on growing our services business and that's why we're comfortable beginning our – we were comfortable with beginning our work on customer and project selection last summer to build a healthier book of business. For some context on the quarter. On the delays were a mix of funding, permitting and scope changes, pushing back the anticipated start times for certain projects across the business. But none of these projects are cancellations. And in most cases, the issues causing the delays have been resolved. And – But we feel like we're about 90 days behind where we expected to be. And that's why Kevin commented that we were tracking towards the low end of our full year guide for revenue.

Regarding confidence, I mean, we have really good confidence. I could feel like the business is in a really good place today as we move into the back half of the year, as we work our way through some of these delays, our backlog is growing. And, I mentioned in my remarks that it's increased by more than $500 million since the start of the year. And the best part about it is it's healthier. And so, some of the customer attrition and some of the work that we've had to do to raise pricing and make sure that we're working for the right clients, I mean, sometimes that's hard. And some of those changes are hard, but I feel like our team and our business has really, really managed their way through that. And sometimes, when you have some of these delays, you still – you end up still, trying to manage what are you going to do with the people and the field leaders that you would utilize on

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those existing projects? And it makes it more challenging to navigate those waters. And I feel like, like I said, our team has done a really good job. So, I feel like we're growing momentum as we are heading into the quarter and into the back half of the year. We're just sitting a little bit, little bit behind where we thought we would be, last time we talked, so. I don't know, Kevin, would you add anything to that?

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

Sure. Yeah. Hey, good morning, Kathryn. First thing I would say, as Adam pointed out, I actually misspoke on the call. We brought up the bottom end of our EBITDA range to $885 million. I think, I said $855 million on the call. So, apologies for that. But our bottom end of our range is $885 million. So, our current range is $885 million to $915 million. Yeah. Russ talked about momentum in our business. I would say, even in Q2 as we missed or we're off or the midpoint of our guide from a revenue standpoint, we over delivered at margins. Our margins continue to hang in there and perform really well and that's what gives us confidence even as we move into the third quarter here, that we're going to be able to continue to sort of drive margin expansion year-on-year and sort of outsized performance with respect to margins.

Some of the elements that helped us in the second quarter, Kathryn, were the work we did do and we closed out, we closed out at higher margins than expectations. So, the teams continue to execute even on what we expect to be higher margin project work, they're executing above expectations. Also from a cost standpoint, our international team has done a really good job continuing to manage cost and accelerating their value capture as they move through the year. So that's been favorable and we expect that to continue. And then, we did see favorable business mix impacts at margins just due to the – our service growing at a higher rate than our projects business. And as our project business ramps up in the third quarter, we would expect that margin impact to be favorable as well as we move into the back half of the year. So all in, as we said, we feel good about margins and our ability to execute in the back half of the year as well.

Kathryn I. Thompson
Analyst, Thompson Research Group LLC
Q

Okay, great. And my follow-up question is on free cash flow generation. And you're seeing an acceleration of that in the back half of the year, as you indicated in today's commentary. Balancing where we are from your net debt level along with M&A, could you give us an update just in terms of your uses of cash as we focus on the back half of the year? Thanks very much.

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

Yeah. So just additional color on free cash flow delivery. Just as a reminder, in a normal year, we're going to deliver somewhere between 20% to 30% of our full year cash flow conversion due to seasonality in the first half. And we're going to deliver 70% to 80% of our free cash flow in the back half of the year. And that's the expectation this year. As we move through the year, delevering is still a priority as it has been, and we're going to do that as we continue to reduce our leverage from where it is today at [ph] 2.7 times instead of 2.5 (00:26:34). But after that, M&A remains a priority. We've closed, as Russ said, on six bolt-on transactions in the first half of the year, plus Elevated spent north of $600 million. And we still have plans, as we've said, to continue to invest in our back – or our pipeline and continue to do bolt-on transactions as we move through the back half of the year.

Kathryn I. Thompson
Analyst, Thompson Research Group LLC
Q

Okay, great. Thanks very much.

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

Thanks, Kathryn.

Operator: Your next question comes from the line of Andy Kaplowitz of Citigroup. Please go ahead.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Hey. Good morning, everyone.

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

Hey, Andy.

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

How are you?

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Good. How are you? Russ, maybe you can talk about the overall macro environment that you see. Obviously, leading indicators are all over the place in non-res construction, but your backlog, as you said, is growing. So, can you talk about the verticals that are driving that growth and update us specifically on what you're seeing in the data center market or how APG is playing in that market?

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

Yeah, so the data center market obviously is an end market that we're very active in. It's screaming every place you look, you hear more and more about, the opportunities in data centers. And, again, our focus is leading on the inspection and service side of data centers. And we want our inspection and service relationships to lead to our project-related work. And there's been just countless, it's like opportunity after opportunity in the space.

One thing I would do to just level set a little bit is that when you think about a data center expansion, we're focused on the fire life safety piece of that expansion project opportunity, which is going to be significantly smaller than the – say, mechanical and electrical packages. Those data center projects are probably north of 80% mechanical HVAC and electrical. And the HVAC or the life safety opportunities are smaller.

We're also seeing really robust opportunities in semiconductor space, advanced manufacturing, which would include, pharma as well as, the electric vehicles/battery space. Healthcare remains really robust. And in some instances, for specific businesses of ours, we're seeing opportunities in the aviation space as well as in the sports and entertainment space.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

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It's helpful, Russ. And maybe you could talk about the confidence you have if organic revenue growth does remain a little light? That you continue to offset lower growth with higher margin. And Kevin talked about it a little bit, but is Chubb value capture actually trending higher than that [ph] $125 million (00:29:30) that you previously gave us? And then, maybe the new $500 million of backlog that you mentioned, Russ, is that coming in at materially higher margin than your current revenue?

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

So Andy, it's amazing how you wrap like three or four questions into one.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

I'm pretty good at that.

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

Yeah, that's good. That [ph] KG (00:29:49) veteran in you.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

Yeah.

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

You know, I would say. Well, I mean, in my remarks, I talked about margins and I talked about the 13% margin as, as our target for 2025. And that's obviously the goal that we stated. And I also said that we think that we can continue to expand from there. And so, I feel really good about, the opportunities in front of us as we, kind of continue to, well, grind through the course of this year, so. We've shown that we can grow and expand our margins and we will continue to grow, and expand our margins as we work our way through the back half.

The $500 million of, increased backlog is, without question, healthier. When you look at it, it's like, it would be hard for me to tell you that there's, 250 basis points of margin improvement in it or whatever. Directionally, that would probably be somewhat correct. But for us, it varies by business. And so, the mix is important in what that backlog looks like. But it's without question, it's much healthier. And I feel like, I missed one of your three.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.
Q

The Chubb, sort of what's going on over there?

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

Oh. Yeah. Well, we're not going to raise the value capture target, the [ph] $125 million (00:30:11). I mean, we're on track with that and we have plans in place to deliver that. And, we feel good about where we're at. I'm – I mean, we track it and we need to continue to track it. My brain is kind of like we're more getting to business as usual and, mode, in that business and, focusing on growth and we just had a Board meeting and we had a number of our international leaders here. And, with some of the work that our International Sales leader has done,

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kind of transforming his sales team and everything else, he's sitting by me. So, I'm just kind of, I'm having a little bit of fun with it too.

But, the work that they're doing to transform, our sales team and starting to lead with, service and inspection work, in the markets that they serve. I mean, we're going to really start to feel the rewards of that work really as we move into the first part of next year. So, I'm really excited about it and I feel like we're in a really good place with Chubb and into our international business just in general as it relates to integrating them.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Appreciate all the color.

Operator: You next question comes from the line of Julian Mitchell of Barclays. Please go ahead.

Jack Cauchi
Analyst, Barclays Capital, Inc.

Q

Hi. Good morning. This is Jack Cauchi on for Julian Mitchell. The implied Q4 EBITDA is up slightly sequentially versus historically being sequentially down. Can you explain what assumptions macro drivers are driving the difference versus prior seasonality?

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

A

Yes, sure. Hi, this is Kevin. I'll take that. The primary driver of that this year is the fact that we expect our project business to accelerate in the back half of the year off sort of the numbers that Russ referenced earlier. And so, our expectation would be that our growth rate in projects accelerates in the back half of the year. Traditionally, our projects flatten out and are slightly down Q3 to Q4. But this year we're expecting our projects business with the backlog coming on that Russ referenced to actually sequentially step up. So, that's the largest driver in it. We also expect margin expansion in the back half of the year, but that traditionally, that's going to happen year in and year out. So, it's really the acceleration of the project business.

Jack Cauchi
Analyst, Barclays Capital, Inc.

Q

Thank you. And just a quick follow up. Margins are solid in both segments. You mentioned earlier raising the margin targets in early 2025. How should we think about that by segment?

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

A

Well, I mean, number one, we're not going to tell you, where we're going to raise the targets until we, we need to deliver on our 2025 goals first. And then, we will share, kind of, where we're going. But directionally, we expect every piece of our business to continue to improve and expand their margins. And as you know, nobody, so to speak, gets a reprieve. And the expectations are that everybody will continue to grow. And we want to make sure that we're taking advantage of our higher margin businesses, obviously. But, if you look across our portfolio of companies, every single one of them has opportunities to improve and to be better. And that's the expectation. And, we'll clearly lay that out, early, next year.

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Jack Cauchi
Analyst, Barclays Capital, Inc.

Q

Understood. Thank you for the questions.

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

A

Thank you.

Operator: Your next question comes from the line of Heather Balsky of Bank of America. Please go ahead.

Emily Marzo
Analyst, BofA Securities, Inc.

Q

Hi. This is Emily Marzo on for Heather Balsky. Good morning. I'm wondering if you could give us some color on what you're seeing on pricing. Are you getting any pushback and how does that factor into your second half guidance?

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

A

Hi, Emily. This is Kevin. I'll take that. So, the short answer is, we have continued our pricing focus, especially on the service side of our business. You know, we say year in and year out, we're pushing pricing campaigns that drive margin expansion on the service side of the business. Our teams have done a great job. It looks different as you work around the world, but generally they've – across to our service businesses, especially in the life safety space, our teams have continued to push pricing in the way that it drives margin expansion on that side of the business. We are always, in dialogue with our customers around that. But I would say, at this point, our customers continue to appreciate the value we bring. Our pricing continues to work and we expect that to continue through the back half of this year.

Emily Marzo
Analyst, BofA Securities, Inc.

Q

Thank you.

Operator: Your next question comes from the line of Jon Tanwanteng of CJS Securities. Please go ahead.

Jonathan Tanwanteng
Analyst, CJS Securities, Inc.

Q

Hi. Good morning and really nice job on the margin, guys. I was wondering if you could talk more about the delays. Was there any specific end market or commonality between them or was it several independent headwinds that co-incidentally [ph] hit (00:36:37) Q2? And then beyond that, what is the risk of further push outs at this point?

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

A

Well, I mean, I would say, to answer your question, it's kind of across every aspect of it. You know, like I was, I'm just reflecting on your question, like we had a permitting delay. It was a large project opportunity with one of our infrastructure customers kind of in the Northeast. And that's been resolved. And we're actually on the site. We had

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actually a utility client of ours that had kind of a start and a stop to one of their work programs that we have an [ph] MSA (00:37:24) with and that, those issues are kind of been resolved. And we expect to have boots on the ground here in the month of August. And so, that's been resolved. We have a North American safety client, who on a project opportunity is making some changes with their general contractors which has slowed down, the forward movement in that. We had some delays in our Asian business, which is in the fire and security space. So, it's kind of – it's been a little bit of everything, Jon. I don't think any one – necessarily, one aspect has been 100% immune from it. And that is just clearly why – one of the reasons that we're so focused on growing our business from a [ph] maintenance (00:38:15) service and monitoring first focus so that the lumpiness associated with some of your project work doesn't have an impact on the business and the results of the business. So, I mean, that's the most important thing about our strategy and what differentiates us from some of the folks that we get compared to from time to time.

Jonathan Tanwanteng
Analyst, CJS Securities, Inc.

Q

Okay. Fair enough. Thank you. And then just regarding the backlog, and I know that's getting away from your inspection and services focus, but just what end markets drove the backlog increase and how much of that was from the EFS acquisition?

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

A

Oh, I mean, not a lot has been driven by the acquisition. I don't know. Maybe approximately 10% of it, maybe a little bit more from the acquisition, but not much more than that. And thinking about Elevated, I mean, remember that north of 70% of their revenue comes from service inspections, repair and maintenance. And really they're not doing, so to speak, new construction. Their project-related work is modernization and upgrades on existing elevators in existing facilities. So one could almost argue that that's service work as well, but that's kind of their version of project work.

I would say that it's coming – that increased backlog is coming in the right space. I – probably when I was talking about end markets, the one thing that I didn't talk about is the infrastructure space and some of the opportunities that we're seeing coming specifically in the infrastructure space. There's a lot of opportunity there. But we're seeing tremendous amount of activity in data, we're seeing tremendous amount of activity in the semiconductor space. We're starting to see some increase in the warehouse distribution center space that's been lagging. But you're starting to see some increased activity there. I think people are anticipating interest rate cuts, but – so you're seeing more activity there. But healthcare remains robust with a lot of opportunities as well. So really the end markets I talked about. The only one I really missed was kind of the infrastructure space.

Jonathan Tanwanteng
Analyst, CJS Securities, Inc.

Q

Great. Thank you, guys.

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

A

Thanks, Jon.

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

A

Thanks, Jon.

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Operator: Your next question comes from the line of Stephanie Moore of Jefferies. Please go ahead.

Stephanie Moore
Analyst, Jefferies LLC

Q

Hi. Good morning. Thank you.

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

A

Hey, Stephanie.

Stephanie Moore
Analyst, Jefferies LLC

Q

Maybe just starting...

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

A

How are you?

Stephanie Moore
Analyst, Jefferies LLC

Q

I'm doing well. Thank you. Maybe just starting on the M&A front, kind of a two-part question within that. Can you kind of first talk about your desired source of funding to source – to fund M&A deals going forward? And then also your appetite for doing potentially larger deals maybe of similar size as the Elevated deal or maybe even larger, especially if the transaction would accelerate your reoccurring revenue targets and/or margin profile targets, et cetera. Thank you.

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

A

I didn't really catch the first part of your question, Stephanie, but the second half of the question regarding other transactions the size of Elevated, if it was the right fit, I would say, feel like that would be something that would be digestible for us. I think we would – we'd have some interest. It's got to fit kind of the profile that we'd be looking for with the high element of recurring revenue and inspection, service and monitoring. The margin profile would have to be accretive. Obviously, we'd have to be able to acquire the business at the right price.

Regarding larger than that, I mean, you can never say no to anything. But I don't know that that's where our attention is sitting right now. The reality of this is we're really focused on integrating Elevated and bringing their team into the APi family and making that a positive journey for them. We had actually a couple of their key business leaders at our board meeting. They got a chance to present on their business yesterday. And one of their leaders called us their forever home, and that really stuck with me. And I think that we owe them the right level of effort to really, truly make this a forever home so that they feel good about where it's at and – but we do have a keen interest in continuing to expand in that space. And Kevin will handle the first half of your question because I didn't hear you.

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

Yeah. Hey, Stephanie. Good morning. On funding our bolt-on campaign, year in and year out, our campaign is going to be aligned with our ability to fund it through free cash flow. That's sort of how we tackled it this year and that's how I would expect us to tackle it in years to come. We produce enough cash flow, and we'll prioritize it to make sure that we're able to do the bolt-on M&A that we plan on in any given year.

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

Yeah, I mean Kathryn (sic) [Stephanie] (00:43:34), the...

Stephanie Moore
Analyst, Jefferies LLC
Q

Got it.

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

...the reality of it is like this tuck-in market, like we spent $100 million last year, and we've said that we're going to accelerate that in the course of this year. We still have half a year to go. But directionally, it'll be north. It'll be in excess of 2x of what we spent in last year. And we continue – we plan to continue that drumbeat, and our pipeline of the right bolt-on opportunities is really robust. And we feel really good about the businesses that we're acquiring and the teams of people that we're bringing into the APi family. It's – our M&A team is doing a great job.

Stephanie Moore
Analyst, Jefferies LLC
Q

Understood. And then maybe just following up on some of the margin questions that have been asked thus far and kind of – well, I guess ask this, but clearly, I think margin improvement, it remains an ongoing priority this year and obviously into next year as you noted. Can you talk about how much of the margin expansion opportunity is predicated on kind of the rebound in organic growth versus how much can you still achieve just based on kind of self-help initiatives and synergies and the like, such kind of other tailwinds that you have? Thank you.

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

Hey, I'll take that, Stephanie. So if you look at – just to level set over the last eight quarters, the back half of last year, we expanded gross margins over 200 basis points. First half of this year, we're over 300 basis points. The levers that we've been pulling on there, we've been talking about it, it's mix which is driving higher growth and a higher percentage of our overall revenues from inspection, service and monitoring. That's going to be a driver that's going to continue to have an impact for years to come.

We talked about pricing on the service side of the business. That's going to be a driver that has an impact. Margin expansive pricing, that's going to have an impact as we move into 2025 and beyond. I'll say some of the impacts that have been driving the significant expansion we've seen over the last eight quarters like material costs coming down and the impact that's had, both the headwind on the way up and the tailwind on the way down, that will obviously subside.

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Also, we took – we tackled a lot of this backlog work and disciplined customer and project selection started last year. So the improvement in the health of the backlog has been significant as we've moved over the last four quarters. We're obviously going to stay focused on the project side of our business and improving margin there, but that impact would subside as well. But it's really pricing, continued service mix. And as we move into future years, our ability to continue to scale our operations to drive productivity is going to be sort of the new driver we're going to be focused on. And that too will have margin impacts as we move into 2025 and beyond.

Operator: Okay. Your next question comes from the line of Josh Chan of UBS. Your line is now open.

Joshua K. Chan
Analyst, UBS Securities LLC

Q

Hi. Good morning. Russ and Kevin, thanks for taking my question. I was wondering if you could give us the service versus project breakdown within the Safety segment. And then kind of focusing on the service side of things, which I think is probably in the mid-single digit range, is that the right pace of Safety Service growth going forward in your mind?

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

A

Yeah. Hi, Josh. I'll take that. So in the first half of the year, if you think about it that way, our service business on the safety side continued to perform at mid-single digits. Our international team, as well as our North America team have stayed focused on that. We've continue to have good results and we expect that mid-single digits growth rate to improve as we move into the back half of the year. Project side, on the other hand, we talked about the work the international team has been doing. That was a drag on the safety segment in the first half of the year. But as we move into the back half of the year, we expect that to improve as well and expect to see growth in the projects business on the safety side of our business as well.

Joshua K. Chan
Analyst, UBS Securities LLC

Q

Great. Thank you for that color. And kind of dovetailing on that, as the project business re-accelerates, how do you think about balancing that? And there was a margin benefit that you've gotten from mix in the most recent quarters. How should we think about margins as that mix, maybe benefit, maybe potentially lessens?

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

A

That's a good question. I think it's still going to be a benefit in Q3. In Q4, or in any quarter where our projects business outgrows our service business, it could be a bit of a headwind. But as we look in the back half of the year with the acceleration in our service business or even into Q4, I don't see the mix slipping on us from a projects versus service standpoint with respect to our margin expansion efforts.

Joshua K. Chan
Analyst, UBS Securities LLC

Q

Great. Thanks for the time and good luck in the second half.

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

A

Thanks, Josh.

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Operator: Your next question comes from the line of Steve Tusa of JPMorgan. Please go ahead.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Hi. Good morning.

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

A

Hey, Steve, how are you?

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Not too bad. Congrats on the execution. It's definitely a choppy environment out there, that's for sure. The – just see the segments. Can you just give us some color on how you expect them to – just relative to the 2Q organic growth rates for each, how you expect them to play out for the next couple of quarters? It's obviously a pretty significant acceleration. Obviously, the $45 million is getting pushed into the second half, so that helps the comps, obviously. But it's a little lumpy. So maybe just a little bit of help around the framework around the organic for each of the segments in the second half.

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

A

Yeah, Steve, hey, this is Kevin. I'll take that. I'll just break it down between safety and then our specialty segment. So safety again, in the first half of the year, we saw mid-single digit service growth. We saw low-single digit decline on the project side of the business, largely driven by the work we're doing in HVAC [ph] and (00:50:19) the international teams on disciplined customer and project selection. As we move into the second half of the year, we expect our service to still be in mid-single digits, but to improve sequentially from a growth rate standpoint. And we also expect the project side of the business to move from slightly down to low-single digit up from an organic growth standpoint. Drivers of that will be our HVAC business and our international business, which were down in the first half that we would expect to be up and continue to work through sort of that new backlog that Russ talked about in the back half of the year.

On the specialty side of the business, our service there was actually up and showed organic growth in the first half of the year, mid-single digits. And we would expect that to continue in the back half of the year as well. Our project business was down significantly. I think we touched on it on the call, low-double digit teens, and we would expect that to improve in the back half of the year as well. And we expect that business or the projects on the specialty business to actually get to low-single digit growth as well in the back half of the year.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. So like around the – do you expect every segment for every quarter to be positive organic or will specialty remain negative organic in the third and then flip positive in the fourth on specialty?

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

A

Specialty should be flat to slightly up from an organic growth standpoint in the third quarter.

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C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay. That's super helpful. And then just lastly, on the acquisition, the 3% contribution for Safety Services, is that – should that be relatively consistent as we move through the rest of the year?

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

A

Yeah. As we annualize against the Elevated transaction, yeah, you can think of it about a 3% impact.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Okay, great. Thanks a lot for the color.

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

A

Appreciate it, Steve. Thanks.

Operator: Your next question comes from the line of Ashish Sabadra of RBC Capital Markets. Please go ahead.

David Paige
Analyst, RBC Capital Markets LLC

Q

Hi, this is David Paige on for Ashish. I just had a question on the Elevated acquisition. Can you tell us maybe some early learnings that you have from them, some of the positive surprises? Anything around – and then also anything around how their [ph] end markets (00:52:52) are looking, but – thank you.

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

A

Oh, man. I would say that the positives are the quality of the leadership team and maybe the depth of the leadership team. Our North American Safety Services segment leader went on like a one-week kind of tour with their team and just came back really raving about the quality of the people that he had the opportunity to interact with. He even commented about how a young apprentice, he showed up on one of their customer sites and didn't have safety glasses on. And one of his – one of their apprentices approached him and asked him to please put his safety glasses on. And so it just – it spoke lot to the culture of the company and the investment that they're making in their field leaders. So it's a – that's all really positive.

I don't know that I would say that there's anything, any necessarily surprises. We bought the business from a private equity firm. And I think that some of the things that you would expect when you – when a sponsor tries to polish up a business and get ready for – get it ready for sale, came through. And that's – I guess nobody is ever surprised by that. You might be surprised what closet it's in, but other than that, you're not really surprised. So I'd say it's business as usual, and we're really fired up about the Elevated team joining the APi family.

David Paige
Analyst, RBC Capital Markets LLC

Q

Great. Thank you.

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

Russell A. Becker

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

Well, thank you so much. And in closing, I would really again like to thank all of our team members for their continued support and dedication to our business. I am truly grateful for what each and every one of you do on a daily basis, and your efforts really, truly are amazing. 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 ownership of APi and look forward to updating you on our progress throughout the remainder of the year. So thank you everybody.

Operator: Ladies and gentlemen, that concludes today's call. Thank you all for joining. You may now disconnect.

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