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APi Group Corp. (APG)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the APi Group's Fourth Quarter 2022 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'll now turn the call over to Olivia Walton, Vice President of Investor Relations at APi Group. Please go ahead.

Olivia Walton

Vice President-Investor Relations, APi Group Corp.

Thank you. Good morning, everyone, and thank you for joining our fourth quarter 2022 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, February 28, and we have no obligation to update any forward-looking statement we may make. As a reminder, we have posted a presentation detailing our fourth quarter financial performance on the Investor Relations page of our website.

Our comments today will also include non-GAAP financial measures and other key operating metrics. The reconciliation of and other information regarding these items can be found in our press release and on our presentation.

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

Martin E. Franklin

Co-Chair, APi Group Corp.

Thank you, Olivia, and good morning, everyone. 2022 was another incredible year in the development of APi. Following the acquisition of Chubb in January of 2022, we became the world's leading life safety and security services provider. We created a business that is focused on statutorily mandated services that benefit from recurring revenue with 26,000 team members operating in over 20 countries.

APi has a truly global platform for our customers and is well positioned to continue to – for continued growth and margin expansion, providing fully integrated seamless service to multinational corporations on a worldwide basis.

2022 marks the year of record net revenues, record adjusted EBITDA and record adjusted diluted earnings per share. We are pleased with the execution and leadership across APi to build on our already solid foundation for a very bright future. As many of you know, we held an investor event on November 17 to provide a thorough walkthrough of Chubb, as well as our continued path of deleveraging swiftly to our targeted range of 2 times to 2.5 times net debt to adjusted EBITDA and our continued focus on thoughtful incremental M&A.

We believe we are well-positioned for continued organic growth and margin expansion and that we have the appropriate strategy and action plans in place to achieve our target [ph] 2025 (00:03:45) levels with a healthy runway for continued growth beyond 2025.

With that, I'll hand the call over to Russ. Thank you.

Russell A. Becker

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

Thank you, Martin, and good morning, everyone. Thank you for taking the time to join our call this morning. Before we report our record results for 2022 and solid outlook for 2023, I would like to start by thanking those of you that joined us for our Investor Update event in November and last week in Miami at the Barclays and Citi conferences. Based on the feedback received in November and again last week, we believe that investors have a clear understanding of the strategy we have to make the most of the opportunities in front of us and achieve our goals as we continue to focus on shareholder value creation.

As you've heard me say in prior calls, the safety, health and wellbeing of each of our team members remains our number one priority. We remain grateful for their hard work and effort. This focus and other foundational priorities provide the platform from which we can continue to enhance shareholder value. 2022 was a year of record financial results for APi. We delivered strong organic growth, adjusted EPS, and free cash flow growth in a

challenging macro environment. We believe this once again demonstrates the stability of our recurring revenue services-focused business model and the ongoing execution of our strategy by our talented team members.

Key specific highlights for the year ended December 31, 2022 include the following. First, net revenues increased on an organic basis by 12.2%, driven by a double-digit increase in inspection, service and monitoring revenue in our legacy business. We achieved our goal of growing inspection revenue 10% plus and continue to drive towards our goal of 60% plus of total net revenues coming from inspection, service and monitoring. As a reminder, on average, inspection and service revenue generates approximately 10% higher gross margins than contract revenue. And monitoring revenue generates approximately 20% higher gross margin than contract revenue.

Second, adjusted gross margin grew by 288 basis points to 26.8%. We are pleased with the execution and leadership across our businesses to offset margin pressures through pricing activities, focused growth in inspection, service and monitoring, strong spend controls, procurement initiatives and disciplined project and customer selection.

Third, adjusted diluted earnings per share increased by 29.1% or \$0.30, driven by strong operational performance and accretion from the acquisition of Chubb. Fourth, adjusted free cash flow of \$412 million, representing an 84.8% increase, compared to the prior-year period. In summary, the business continues to perform well and delivers on its commitments, driven by strong organic growth and solid operational performance, as well as our ability to mitigate margin pressures that exist on a macro basis.

Chubb continues to perform in line with our expectations. We've had more positive than negative surprises, and most importantly, what we have found has only reinforced our excitement about the acquisition. Compared to a five-year CAGR of 0% before our ownership, Chubb delivered solid organic growth in 2022, despite COVID-19 supply chain disruptions, inflation and a difficult macro environment. As planned, we completed the work of transitioning Chubb from services provided by its prior owner by year-end 2022. This involved a tremendous amount of work and significant process improvements and we are grateful for the hard work across our teams. The integration is occurring swiftly, savings are significant, and we continue to be energized by the opportunities in front of us as the world's leading life safety and security services provider.

As outlined at our Investor Update in November, we see a clear path to a 2025 runway value capture opportunities of at least \$100 million. Our enhanced platform is already driving wallet share gains with overlap customers, and we are excited about the opportunities to expand cross-selling of services offerings. As we look ahead, we are focused on continuing our efforts to build a global and coordinated inspection salesforce to drive our go-to-market strategy of selling inspection work first, which we believe will lead to further service revenue growth and ultimately drive margin expansion.

We entered 2023 with positive momentum on many fronts. Our backlog remained strong and was up approximately 9% as of December 2022, compared to the end of December 2021. We remain focused on being disciplined on project and customer selection and will continue to focus our efforts on growing the acyclical recurring service revenue aspects of our portfolio rather than growing for the sake of growth and risking profitability.

While some parts of the world are in a recession and others may enter a recession, we believe that the statutorily driven demand for our services and the diversity of the end markets we serve provide predictable recurring revenue opportunities and help to build a protective moat around the business. As part of our annual budgeting process, each of our operating companies presents a long term strategic plan. In addition, we challenge each of our operating companies to prepare a downturn plan that addresses any potential challenges unique to their

market and operations. We are confident that our business leaders are prepared, not only on paper through our downturn plans, but also to take definitive and early action as needed. Whatever the challenge, we intend to build on our successes over the last three years to achieve the goals we have set for ourselves over the next three years. We are confident in the resiliency, growth prospects and strong free cash flow generation of our business and remain focused on capitalizing on opportunities in front of us, while maintaining a conservative balance sheet and liquidity profile.

Our balance sheet is strong, which provides us the flexibility to pursue attractive capital allocation, including M&A. We believe that the markets in which we operate are highly fragmented and we are keeping a close eye on the opportunity set. We have an extensive pipeline of potential bolt-on opportunities for life safety and security services businesses.

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

Kevin Krumm

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

Thanks, Russ. Good morning, everyone. I'll begin my remarks by reviewing our consolidated results and segment level operating performance for the fourth quarter and full year before turning to our outlook. Reported net revenues for the three months ended December 31, 2022 increased – sorry – 2022 increase by 53.1% to \$1.7 billion, compared to \$1.1 billion in the prior-year period. This is driven by revenue from acquisitions completed in Safety Services. Net revenues increased on an organic basis by approximately 6%, driven by strong organic growth in Safety Services. Consistent with prior quarters, approximately two-thirds of this growth was driven by price and pass-through of material and labor costs, and one-third was driven by volume, which we measured through labor hours.

For the year ended December 31, 2022, reported net revenues increased by 66.4% to \$6.6 billion, compared to \$3.9 billion in the prior-year period, driven by revenue from acquisitions completed in Safety Services. Net revenues increased on an organic basis by 12.2%, driven by double-digit growth in inspection, service and monitoring revenue for our legacy businesses in Safety Services. Approximately two-thirds of this growth was driven by price and pass-through of material and labor costs, and one-third was driven by volume.

Adjusted gross margin for the three months ended December 31, 2022 was 27.8%, representing a 319 basis point increase, compared to the prior-year period, driven by acquisitions in Safety Services and an improved mix of inspection, service and monitoring revenue. For the year ended December 31, 2022, adjusted gross margin was 26.8%, representing a 288 basis point increase, compared to the prior year, primarily driven by reasons provided in the review of the fourth quarter. Adjusted EBITDA margin for the three months ended December 31, 2022 was 10.7%, representing a 40 basis point increase, compared to the prior year, driven by an improved mix of inspection, service and monitoring revenue and leverage on higher volumes in Safety Services.

For the year ended December 31, 2022, adjusted EBITDA margin was 10.3%, consistent with prior-year adjusted EBITDA margin of 10.3%. Margins were negatively impacted by supply chain disruptions, inflation and mix from completed acquisitions, offset by an improved mix in inspection, service and monitoring revenue, and leverage on higher volumes. Adjusted diluted earnings per share for the fourth quarter was \$0.36, representing a \$0.07 increase, compared to the prior-year period. The increase was driven by strong organic growth in Safety Services and accretion from acquisitions. For the year ended December 31, 2022, adjusted diluted earnings per share was \$1.33, representing a \$0.30 increase from the prior-year period, driven by accretion from acquisitions and strong organic growth in Safety Services and Specialty Services.

I will now discuss our results in more detail for Safety Services. For the three months ended December 31, 2022, Safety Services reported net revenues increased by 111% to \$1.2 billion, compared to \$569 million in the prior-year period, driven by revenue from completed acquisitions and strong organic growth. Net revenues increased on an organic basis by 18.1%, compared to the prior-year period, driven by a double-digit increase in inspection, service and monitoring revenue. For the year ended December 31, 2022, Safety Services reported net revenues increased by 120% to \$4.6 billion, compared to \$2.1 billion in the prior-year period. And net revenues increased on an organic basis by 17.1%, driven by reasons provided in review of the fourth quarter.

Adjusted gross margins for the three months ended December 31, 2022 was 32.4%, representing a 146 basis point increase, compared to prior year, driven by the impact of completed acquisitions, pricing initiatives and disciplined project and customer selection. For the year ended December 31, 2022, adjusted gross margin was 31.3%, compared to the prior-year adjusted gross margin of 31.5%, driven by inflation and certain supply chain disruptions which caused the decline in productivity. This was offset by an improved mix in inspection, service and monitoring revenue, pricing initiatives and the impact of completed acquisitions.

Adjusted EBITDA margin for the three months ended December 31, 2022 was 13.2%, compared to the prior-year adjusted EBITDA margin of 13.5%, primarily – driven primarily by SG&A mix impacts from completed acquisitions. For the year ended December 31, 2022, adjusted EBITDA margin was 12.2%, compared to prior-year adjusted EBITDA margin of 14%, driven by SG&A mix impacts from completed acquisitions and the reasons provided in review of gross margins.

I will now discuss our results in more detail for Specialty Services segment. Specialty Services reported net revenues for the three months ended December 31, 2022 declined by 8.9% to \$510 million, compared to \$560 million in the prior-year period, driven by timing of projects at our specialty contracting businesses and a robust sales performance in Q4 2021. For the year ended December 31, 2022, Specialty Services reported net revenues increased by 6.4% to \$2 billion, compared to \$1.9 billion in the prior-year period, driven by an increase in service revenue, increased demand at our infrastructure, utility and fabrication businesses, and improved capture of inflationary-driven price and cost pass-through. Adjusted gross margin for the three months ended December 31, 2022 was 16.7%, representing an 83 basis point decline, compared to the prior year, primarily driven by margin declines, which arose due to inflationary cost pressures and productivity constraints on select jobs. This was offset by an improved mix of service revenue and improved productivity. For the year ended December 31, 2022, adjusted gross margin was 16.2%, representing 100 basis point increase, compared to the prior year, driven by improved productivity and improved mix of service revenue. These factors were offset by inflation and supply chain disruptions, which caused downward pressure on margins.

Adjusted EBITDA margin for the three months ended December 31, 2022 was 10.4%, representing a 139 basis point decline, compared to the prior year, due to the reasons provided in the review of gross margins. For the year ended December 31, 2022, adjusted EBITDA margin was 10.3%, representing a 12 basis point increase, compared to prior year, due to the leverage on higher volumes.

Turning to cash flow. As expected and consistent with historical trends, we saw strong sequential free cash flow performance in Q4 relative to Q3. For the three months ended December 31, 2022, adjusted free cash flow was \$230 million, above our previously guided range from \$190 million to \$210 million and representing an \$84 million increase, compared to the prior-year period. This increase was driven by the positive contribution from acquisitions, continued focus on working capital discipline and strong EBITDA growth in our legacy businesses. For the year ended December 31, 2022, adjusted free cash flow was \$412 million and adjusted free cash flow conversion was approximately 61%.

As of December 31, 2022, our net debt to adjusted EBITDA ratio was 3.1 times and the weighted average maturity of our debt was over five years, with the earliest maturity in 2026. As part of our 2023 deleveraging plan, we paid down \$200 million of long term debt in January of this year. We remain laser focused on cash generation and deleveraging at approximately one turn annually as we move towards our stated long term target of 2 to 2.5 times, which we expect to achieve near yearend 2023.

I will now discuss our outlook for 2023. As we look ahead to 2023, we are confident that our relentless focus on growing statutorily required higher margin inspection, service and monitoring revenue, combined with our robust backlog and variable cost structure, positions us well to prosper even if the macro environment continues to be volatile.

As stated in our February 2021 press release, we believe that net revenues for 2023 will range between \$6.8 billion to \$6.95 billion, representing growth in net revenues on an organic basis, in line with our historical performance. We expect Q1 net revenues to be \$1.54 billion to \$1.56 billion. Based on current exchange rates, FX will remain a headwind in Q1. So, this guidance represents a Q1 organic growth of 6% to 8% on a constant currency basis. For 2023 adjusted EBITDA, we expect to deliver \$735 million to \$775 million on strong margin expansion. We remain confident in achieving our goal of 13% plus adjusted EBITDA margin by 2025 through an improved mix in inspection, service and monitoring revenue, procurement savings, value capture opportunities, and leveraging our global scale. We expect Q1 adjusted EBITDA to be \$135 million to \$145 million, which represents organic growth of 8% to 16% on a constant currency basis.

We estimate that we will recognize between \$55 million to \$65 million of restructuring costs related to the Chubb restructuring program in 2023. Not only will these restructuring actions help the bottom line, but they will also significantly reduce organization complexity, making it easier for the team to service customers and focus on driving organic growth and mix.

Depending on how interest rates move through the year, we anticipate interest expense to be approximately \$150 million for 2023 and between \$35 million to \$40 million for Q1. We expect depreciation for 2023 to be approximately \$85 million and capital expenditures to be approximately \$95 million. Our adjusted effective tax rate remains approximately 24%, and we expect our adjusted diluted weighted average share count for 2023 to be approximately 273 million. We expect to arrive at an adjusted free cash flow conversion for 2023 at or above 65%. For Q1, we expect adjusted free cash flow conversion to be flat, which is consistent with prior year and in-line with the seasonality of our cash flows.

I'll now turn the call over to Jim.

James E. Lillie

Co-Chair, APi Group Corp.

Thanks, Kevin. Good morning, everybody. APi's continued strong performance in the fourth quarter was the culmination of what was another outstanding year for APi in 2022. The double digit growth in organic net revenues, combined with the acquisition and continued integration of Chubb, the development of a robust multi-year improvement plan for that business and the company's ability to offset macro headwinds, allowed APi to again produce record earnings and generate substantial free cash flow.

As reflected in the guidance we gave last week for 2023, we have strong momentum balanced across our global platform. Our leaders continue to build on historically strong execution, continue to mitigate macro challenges, and are staying focused on operational excellence. As you have heard all of us, we have great confidence in the business and the direction we're heading. We will continue to remain agile, focused and adaptive as needed to

create sustainable shareholder value by focusing on long-term value creation targets. These include solid organic growth, targeted adjusted free cash flow conversion of 80%, adjusted EBITDA margins of 13% by 2025 and targeted net leverage ratio of 2 to 2.5 times, which, as Kevin mentioned, we expect to achieve near year end 2023, supplemented by our recent \$200 million reduction in term loan debt. Everyone is excited about the opportunities in the year ahead and our ability to execute on our strategic plan.

I'd now like to turn the call back over to Russ and the operator for Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll take a question from Kathryn Thompson of Thompson Research Group.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Hi. Thank you for taking my question today. Just in terms of your outlook, if you could give a little bit more color on what pricing is looking like for 2023, given services won't have an obvious material inflation backdrop. Also, you're just seeing some rationalization in certain categories of pricing across the value chain, be it – whether raw materials and, in some cases, labor, so really being able to give a little bit more detail of that two-thirds growth for price and a third from volume or labor hours. Thank you.

Russell A. Becker

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

A

Good morning, Kathryn. Thanks for taking the time to join our call this morning. Well, there's quite a bit there in your question. I would start by saying that we – I feel like the business has done a very good job of taking price through a very difficult inflationary period and we feel that the price that we've been able to take thus far is sticky and sustainable on the business as we march forward into 2023. We are still seeing inflation in the business. I mean, in past calls, we have talked about how we really watch hot rolled coil closely just because we buy so much pipe. And we've seen – we saw a dramatic decrease in pricing over the – say, the latter half of 2022. But over the course of the last three months, we have seen pipe prices tick up again. And so we continue to monitor that and we continue to focus our businesses on taking price where taking price is appropriate.

We want to make sure that we are fair with our customers, but we want to make sure we continue to take price. Especially in North America when you think about our labor force being primarily union and there is a number of – we feel there is a number of advantages for us to be in union, one of them is stability and visibility into our labor cost. Typically, our union agreements from a wage escalation perspective reset in the spring, usually right around April 1st. That is a very natural time for us to adjust our prices – pricing and to take price with our customers both on the labor and the material side of the business. So, I think Kevin in his remarks said that approximately two – of our organic growth, approximately two-thirds of it came from price, one-third of it came from volume, on the inspection and service side, most of that is volume and we continue to plan to grow our inspections at a double digit clip as we move into this next year. So I would suspect in the latter half of the year, you'll see that two-thirds, one-third moderate a little bit, but we are continuing to take price across every aspect of our business.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Great. Thanks. And just one follow-up question. Given as the year closed, just [ph] a general (00:28:02) greater conservatism given concerns about recession, and understand that you are – your business model is maybe

perhaps not recession-proof, but recession-resistant, but still on the fringes, there could be some indicators, a sign of companies changing their behavior in terms of concerns around the economy. What, if any, changes have you seen behavior-wise in any of your businesses that would give any type of indication that there's a more conservative stance given the economic backdrop? Thanks very much.

Russell A. Becker

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

A

Well, I mean, I would tell you that, right now, we haven't seen that in our business, and that's demonstrated by the strong backlog that we will carry into 2023, as well as what we see in the pipeline from an opportunity perspective. I would say – tell you that we're naturally what I would call a productively paranoid business, which means that we're always looking at the business and to make sure that we're in a position to adjust really quickly if we see any sort of downturn in the economy as it affects our business. I would also tell you that end markets matter, and the end markets that that we serve continue to be strong and resilient, as they have been over the last number of years. Some of that is fueled by the infrastructure bill, some of it's fueled by the chip bill, and a number of different things that are potentially additive to the business.

And then I would say, lastly, where there is concerns about Western Europe, we are already looking at restructuring and optimizing the business. We can be, really in its own way, doing that at a better time than right now. But we remain optimistic. We've got a – 75% of our cost structure is variable by nature. So, if we have to adjust, we will adjust.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Okay, great. Thank you very much.

Operator: Our next question is from Andrew Obin of Bank of America.

David Ridley-Lane

Analyst, BofA Securities, Inc.

Q

Hi, this is David Ridley-Lane on for Andrew. How has supply chain performance been for you over the last couple of months? And when you think back about the disruption and cost impact in 2022, how meaningful will fewer disruptions be in 2023? I know it's tough to quantify, but at least 10 basis points, 20 basis points sound reasonable.

Russell A. Becker

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

A

Yes, go ahead.

Kevin Krumm

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

A

Hey, David. This is Kevin. So, when you talk about supply chain disruption, I'll say, first, we are not out of the woods yet. Things still remain on backlog in certain categories. And we still, with our teams, are battling through that. The inflation and supply chain disruption impacted our business in two ways in 2022. On the inflation side, obviously, the price pass-through that we've been talking about with the margin drag, we've referenced that. We believe as that comes down in 2023, we should get some of that margin back. On the supply chain side, just the lack of material and availability caused pretty significant productivity disruptions in our business. Not just for our

business, but you can imagine places where we work, there's other companies working there too, that may also have had supply chain disruptions, which causes productivity issues for us. So we saw it on the productivity side. I'll say is as things start to moderate in the supply chain, we're seeing productivity improve in the other area as we move into 2023. As the supply chain works through its issues, we would anticipate productivity improvements coming through in margins as well in 2023.

David Ridley-Lane

Analyst, BofA Securities, Inc.

Q

Thank you. And a quick follow-up. You mentioned the end markets that you're serving, just could you kind of give a view on how strong the demand is among the major end markets like commercial, industrial, healthcare, et cetera?

Russell A. Becker

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

A

I mean, what do you mean, David, when you say indication of how strong they are? I mean, data center is really strong. Semiconductor remains very strong. Healthcare remains very strong. Depending upon how you look at the infrastructure spending and the infrastructure bill, those dollars are really just starting to flow into the system. You're seeing some things, federal aid going into rural broadband access and things like that that are having a positive impact on the business. So I think in general, those end markets are really strong. We don't have a lot of exposure to retail hospitality. We don't do a lot of like developer-led type project opportunities that rising interest rates are going to have a negative effect on whether a developer is going to move forward or some of their project-related work. So that's a plus for us. We have very little exposure to residential, including multi-family housing, which is a positive for us. So, in general, I think the focus that we've had on the right end markets has made a difference for us.

David Ridley-Lane

Analyst, BofA Securities, Inc.

Q

That is perfect. Thank you very much.

Operator: We'll take our next question from Julian Mitchell of Barclays.

Kiran Patel-O'Connor

Analyst, Barclays Capital, Inc.

Q

Hi. This is Kiran Patel-O'Connor on for Julian Mitchell. I just wanted to ask on the Chubb synergies. Can you talk about how these are progressing, maybe how much you realized in 2022 and what your expectations are for synergies realized in 2023? Thanks.

Russell A. Becker

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

A

[ph] Yeah, go ahead (00:34:38).

Kevin Krumm

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

A

Yeah. Hey, Kiran, this is Kevin. From a Chubb synergy standpoint, we talked about it in November. So to step back, our restructuring charge in 2022 was approximately \$30 million. As I said on the call, we anticipate \$55 million to \$60 million in restructuring in 2023. The actions that we took, associated with the \$30 million charge in

2022, did bear fruit in 2022 as well. We saw approximately \$5 million to \$10 million of savings come through. We anticipate the remainder of that to come through in 2023. With respect to the 2023 actions and initiatives, we expect most of those charges to occur later in the year and, with that, the savings similar to 2022 will start to come in in the back half of 2023.

Kiran Patel-O'Connor

Analyst, Barclays Capital, Inc.

Q

Got it. Thank you. And then I just had one follow-up on the backlog. I saw you guys noted the backlog was up 9% in 2022. Do you expect to burn through a material portion of the backlog at all or do you expect orders to remain steady with sales growth through the year? Thanks.

Russell A. Becker

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

A

Yeah. So typically, what we see is we'll see -- we'll burn through backlog in the fourth quarter as we move towards the end of the year and then we will build backlog over the course of the first half of the next year. So when you look at our backlog on a year-on-year basis, it's up, but if you look at it sequentially from the end of Q3 through the end of the year, it's slightly down, which is 100% normal for us.

And when we first started talking about backlog, we reminded everybody that that's actually not the greatest metric to measure us [ph] right (00:36:44), because with the processes that we have from a project selection and customer selection, we actually wouldn't mind seeing our backlog shrink a little bit because it would show -- it would demonstrate us that we're being more disciplined with the work that we pursue and that the quality of the backlog is going to have better margins in it as we work our way through 2023. So our backlog is in a really good shape and the funnel that we have with our proposals that we see coming through the system remains very robust.

Kiran Patel-O'Connor

Analyst, Barclays Capital, Inc.

Q

Got it. Thank you.

Operator: Our next question is from Chris Snyder of UBS.

Chris Snyder

Analyst, UBS Securities LLC

Q

Thank you. So, kind of want to talk on some of the prior commentary around margins. If I look at 2023, it seems like at the midpoint, the guidance put EBITDA margin up 70 or so basis points year-on-year. And then the 2025 target implies at least 100 basis points kind of per annum the year after. Can you just maybe provide some color on what is kind of driving that post 2023 reacceleration, whether it's productivity? Or it sounds like some of the Chubb synergies are kind of back half 2023 weighted. Thank you.

Kevin Krumm

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

A

Yeah, I can take that, Chris. So, with respect to 2023, the primary drivers of our margin expansion, and I think your math seems directionally correct when you look at the full year guide at the midpoint, is going to be continued delivery of our value capture opportunities that we talked about in November and it's going to be the stickiness of our pricing and our continued focus there that Ross has talked about earlier on the call. And then the

last component of it will be, I guess, what I referenced earlier on the call, which is the expectation that in 2022, we – our price pass-through was – while we were able to pass it through was a margin drag, primarily on the projects business. And I think in 2023, as pricing comes down, we should get some of that gross margin back.

Chris Snyder

Analyst, UBS Securities LLC

Q

Thank you for that. And then maybe for the follow-up, something more kind of thematic. We're seeing a very high level of investment into the US economy, whether it's reshoring, stimulus – or sorry, infrastructure kind of [ph] bills (00:39:22) on behalf of the government. Can you kind of talk a little about what that means for your business? I think we always kind of think about the drivers here being the installed base, but just kind of an influx of capacity expansion. Kind of what kind of opportunity does that provide? Thank you.

Russell A. Becker

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

A

Well, I mean, [ph] they're (00:39:41) kind of two different things. I mean, like when I think about reshoring and things like that, my brain immediately jumps to the semiconductor space and the level of activity that you see going on with the Intels of the world and Micron and some of those other folks, and the capital spending that they have going on in the United States is very, very robust.

And I would say it's so robust that firms like ours have to make sure that we're disciplined, that we don't overextend our resources, actually, and make sure that the project-related opportunity that we do pursue, we have the capacity to do and do very well, and these are sophisticated customers and being able to deliver a high quality end product is something that's very important. So we've been really disciplined in making sure that we don't overextend in those spaces.

When I think about the infrastructure bill, I think about it more from the whole concept of a rising tide floats all boats, and a lot of the project-related opportunities that will be funded by the infrastructure bill are things that we would not be interested in pursuing. However, our peers in the industry and our competitors in the industry are interested in pursuing that. And as they pursue some of those related opportunities, it creates more space for us with our existing customers to take share, to increase pricing, to improve our margins and that ultimately is a benefit to us. The real broadband spending that the federal government is moving forward with is something that aids our business, specifically a couple of our businesses. But in the scheme of things, it's not a huge driver of revenue in our Specialty Services segment.

Chris Snyder

Analyst, UBS Securities LLC

Q

Thank you for that. Appreciate it.

Operator: Our next question is from Andy Kaplowitz of Citibank.

Piyush Avasthy

Analyst, Citigroup Global Markets, Inc.

Q

Hey, this is Piyush on behalf of Andy. Good morning and thanks for taking my questions. Can you update us on what you're seeing in Europe and China? And as we think of your 2023 guidance, what is your expectation for these regions? Are you banking in a recovery in economic conditions or given the nature of your work, you think you can get to your guidance even without a significant step-up in economic activities there?

Russell A. Becker

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

A

Well, I mean, obviously, we put forth guidance that we have confidence in being able to deliver based on the conditions that we see in both Western Europe as well as in Asia. Our actual presence in China is small. We have a nice business in Hong Kong that has really seen robust opportunities in front of it. And the team there is performing very well. It's a very good team. I actually had the good fortune of visiting them in mid-January and was just super impressed with the quality of our team there. And the level of activity that they're seeing in the marketplace remains very strong. As it relates to Western Europe, we really have not seen a slowdown. Again, I'd just point to the end markets that we're focused on. I would say that if Andrew White was on the call, the one place that he would add color would be pharmaceutical, which is a good base for them and – in addition to the other end markets that I talked about earlier, but I also mentioned that, right now, we're going through kind of a rightsizing and optimization project as it relates to the business in general.

We have some integration activities going on with overlap between a previous acquisition we made with SK-Fire and Chubb, specifically related to the Benelux area. All of that provides a great opportunity for us to get that business optimized and rightsized right now. And then the last thing that I would point you to is that Chubb, right now, over 60% of their revenue comes from inspection, service and monitoring. And so that business is really from – when you think about it from a resiliency perspective is in a really good place.

Piyush Avasthy

Analyst, Citigroup Global Markets, Inc.

Q

Very helpful. And following up on that, like you highlighted strong organic growth in 2022 for Chubb, like an you quantify what that was and also what the business did in terms of margins? I mean, you have like 3% to 5% long term guidance for growth and around 15% plus for EBITDA margins. So as we think of 2023, should we expect growth in that range and margin to progress towards that 15% plus target?

Russell A. Becker

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

A

Well, we don't break out – we shared some information about Chubb at the November investor meeting, but we don't break out their results separately. But you should – you can count on 3% to 5% organic growth in 2023 in the business and I'd just also point you to the fact that some of that is purposeful on our part in trying to hold that back. We have some – I don't know – customer selection opportunities in front of us that we want to make sure that we're taking advantage of, as we continue to optimize and right-size the business. So we're confident that we're going to be able to sustain that level of organic growth in that business and achieve our margin expansion goals by 2025. I think we shared that for Chubb specifically that that margin expansion goal is 15%. And we have good path and good line of sight into that.

Piyush Avasthy

Analyst, Citigroup Global Markets, Inc.

Q

Got it. And one last one like you talked about FCF conversion improvement here. Can you elaborate on different levels and the progress you have made there that helps you with the step-up in 2023 and eventually to get to that 80% target of yours?

Kevin Krumm

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

A

Yes, sure, Piyush. This is Kevin. Good morning. So when we talk about free cash flow conversion both as we exited this year – started this year, exited this year in 2022, and then think about 2023, just as a reminder, we

invested a significant amount of working capital rate in the first half of 2022 as we got out in front of what was strong customer demand and a choppy supply chain. And so, our focus in the back half of the year, as we discussed, was working that working capital rate investment down. We did, you saw it in our results, especially in the back half of the year.

The only other thing I'll point to is in Q4, traditionally, we're going to have a strong Q4 conversion. And so, there is seasonality in our business because of the especially business and the step down there. But as we look forward to 2023, we still have 2022 working capital rate investment that we anticipate getting back. We're going to continue to focus on working capital and we expect to drive further improvements beyond that in 2023. When you think about stepping forward our 2025 goal of 80% free cash flow conversion, we laid this out in November, but the other drivers of that are obviously leverage and interest associated with it and then continued focus on our service business, and the growth in our service business needs to be our projects business.

Piyush Avasthy

Analyst, Citigroup Global Markets, Inc.



I appreciate all the color. Thank you, guys.

Operator: Our next question is from Andy Wittmann of Baird. Your line is open.

Andrew John Wittmann

Analyst, Robert W. Baird & Co., Inc.



Great. Good morning, guys. Thanks for all the detail so far today. I guess I wanted to just dig in a little bit more on the topline guidance here. Heard your commentary for double digit inspection, service, monitoring growth in the Specialty – in the Safety segment. Presumably, that means the Safety segment is up at least high-single digits in total, if not double digits, which would imply that the Specialty business would be closer to flat, maybe low-single digits.

I guess I wanted to understand if that's the correct assumption for your outlook on Specialty. And given that inflation is going to have a revenue effect at least of low-single digits, I would guess, can you talk about the volumes that should be going to your Specialty business compared to last year? And maybe any specific end market comments inside of Specialty, I think that would just be helpful context.

Kevin Krumm

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



Yeah. So Andy, this is Kevin. I'll take a stab at this. So you're right. As we look at 2023 in our full year guidance, right now, we – and underlying what we're expecting in our life safety businesses on the service side is continued double-digit growth. The math that you laid out and the implication to the specialty services seems directionally correct. And what I would add is, we are going to continue to focus in that business in 2023 on disciplined projects, customer selection and market work. Russ talked about it a little bit on the [ph] CHIPS (00:49:41) side, but it's relevant in those Specialty businesses too, as they continue to see increased work opportunity for some of the infrastructure bill and some of the other areas. So we're going to continue to be disciplined in our project selection, and I think you'll see that through 2023 and the growth rates in that business.

Andrew John Wittmann

Analyst, Robert W. Baird & Co., Inc.



Got it. Can you just – I guess there's a comment in the prepared remarks that talks about a robust sales pipeline in the fourth quarter. Can you maybe talk about some of the end market implications where you saw that level of strength?

Russell A. Becker

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

A

Specific to Specialty, Andy, or are you talking about just...

Andrew John Wittmann

Analyst, Robert W. Baird & Co., Inc.

Q

Yeah, yeah, yeah, Specialty, the comment of robust sales in the fourth quarter.

Russell A. Becker

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

A

Yeah. Well, I mean, we just...

[indiscernible] (00:50:28)

Kevin Krumm

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

A

So if there was something in the script, Andy, I think it would have talked about Specialty in Q4 prior year, where we had – in Q4 current year, we had a difficult comp. So if you look at Q4 2021, I think Specialty put up a growth rate north of 20% organic.

Andrew John Wittmann

Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Yeah.

Kevin Krumm

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

A

And generally, what you're going to see as a step-down in that business, Q3 to Q4 in 2021. Because of sort of the run out of COVID and various other types of work we're doing, we actually saw a sequential step-up. And so, when you look at that business operating more normally in Q4 2022 this year, which it did, against that difficult comp in prior year, you saw a reduced growth rate especially in Q4 down a little over 8%.

Andrew John Wittmann

Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Yeah. That not – I'm sorry, I must've misheard you when you heard – when I heard sales, I didn't think revenue. I thought new business sales. So that was the confusion on my part. So I apologize for that.

I guess just one other clarification here. At the Analyst Day, I think your restructuring expenses for 2023 were targeted at \$30 million to \$35 million. I'm hearing \$55 million to \$65 million here. And so I just was wondering what was the change here that's driving that.

Kevin Krumm

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

A

Yeah, that's right. I would say in November – so our overall program and how we're thinking about it has not changed when you look through the years. In November, we were still thinking through sort of the actions we wanted to take in 2023 versus 2024. I think what you saw in the guidance today is that we have more clarity around the sequencing of that. So again, the overall program is still the same [ph] size (00:52:22) we talked about in November, but we're anticipating accelerating activity into 2023. Obviously, with that, we're hoping for – anticipating accelerated savings in the out years as well.

Andrew John Wittmann

Analyst, Robert W. Baird & Co., Inc.

Q

Got it. So the 2024 and the 2025 number is therefore should be expected to be lower.

Kevin Krumm

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

A

Yeah, from a restructuring standpoint. That's right.

Andrew John Wittmann

Analyst, Robert W. Baird & Co., Inc.

Q

Okay, great. All right. Thank you.

Kevin Krumm

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

A

Thanks, Andy.

Operator: Our next question is from Jon Tanwanteng of CJS Securities.

Jonathan Tanwanteng

Analyst, CJS Securities, Inc.

Q

Hi. Good morning, everyone. Thank you for taking my questions. You covered a lot already. I just want to ask my usual questions on M&A. Russ, [indiscernible] (00:53:09) good pipeline that you're seeing out there, and it's maybe Martin, you said that. Just wondering about the expected balance between paying down debt and pursuing tuck-in M&A in this environment. And just what you're seeing in the valuations out there in the pipeline? Are they new or historical? Four to six times opportunities, bigger or smaller? Just any more color would be helpful. Thanks.

Russell A. Becker

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

A

Yeah, I mean, there's obviously a healthy tension to make sure that we're delivering on our commitment to de-lever the business. We've factored that into our cash flow forecasting for this year. And in a similar fashion is now we're looking at CapEx. We've allocated certain levels of dollars for tuck-in M&A. And as we look at the right opportunities that are going to help us expand our margins, that's really where the focus is. As it relates to the traditional multiples that we paid, I would say, yes, we see that. The types of firms that we want from – especially from when you're talking about a tuck-in M&A strategy perspective, we're looking for culture, values and fit and the types of companies that we want to acquire, they're actually doing the same. And if they're really truly interested in only maximizing the price that they get for the sale of their business, it's probably not the right fit for us.

And so, we continue to focus on what are the right businesses to bring into the APi family versus just bringing anybody into the mix. So we see – we still see the – lots of opportunity for us there. We have a lot of space that we can continue to expand and are really excited to really get back on that train and move forward with the right level of M&A in this fiscal year.

Jonathan Tanwanteng

Analyst, CJS Securities, Inc.

Q

Got it. Thanks, Russ. And just a quick question on the synergy realization this year from Chubb. Is there an expected cadence to it or lumpiness or is that mostly expected to be roughly a straight line improvement through the year?

Kevin Krumm

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

A

I think on the actions that we've taken to date, I would say that we should expect that to be less lumpy. On the initiatives that we're going to tackle associated with the \$55 million to \$65 million in restructuring charge in 2023, I think that'll be a little more lumpy in 2023 and early 2024.

Jonathan Tanwanteng

Analyst, CJS Securities, Inc.

Q

Okay. Great. Thank you, guys.

Operator: And this concludes our question and answer session for today. I'd be happy to return the call to Jim Lillie for any closing comments.

James E. Lillie

Co-Chair, APi Group Corp.

And I'd be happy to then give it over to Russ.

Russell A. Becker

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

So I'd just like to take the opportunity to thank all of our team members for their continued support and dedication to our business and I'd also like to make sure I take the opportunity to thank our long term shareholders, as well as those of you who have recently joined us for their support. And we appreciate your ownership in APi and look forward to updating you on our progress throughout the remainder of the year. So thank you again for taking the time to join the call this morning.

Operator: This does conclude today's conference. You may now disconnect your lines, and everyone, have a great day.

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