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APi Group Corp. (APG)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to APi Group's Second Quarter 2023 Financial Results Conference Call. All participants are now in a listen-only mode until the question-and-answer session. Please note, this call is being recorded. I will be standing by should you need any assistance.

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

Adam Fee

Vice President-Investor Relations, APi Group Corp.

Thank you. Good morning, everyone, and thank you for joining our second quarter 2023 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, August 3, and we undertake no obligation to update any

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forward-looking statements we may make, except as required by law. As a reminder, we have posted a presentation detailing our second 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. 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 Jim.

James E. Lillie

Co-Chair, APi Group Corp.

Good morning. Thank you, Adam. APi delivered another strong quarter results, including record net revenues, adjusted EBITDA and adjusted diluted earnings per share in an evolving macro environment. We continue to be pleased with the momentum APi is building with an outstanding first half of 2023. Russ and Kevin will speak to the performance of the business in more detail, but APi's consistently strong financial results speak to the direction we are heading and the strength of the company's recurring revenue service focused business model, as well as the discipline of the organization and its leadership team.

We started this journey with Russ and the team nearly four years ago as a US focused business with approximately $4 billion in revenues. Today, we are significantly larger, with an expectation of delivering over $7 billion in revenue in 2023. The quality of the business and our financial performance has also improved significantly. We are the number one provider globally in a growing, highly fragmented fire and life safety market. We have confidence in the team's ability to expand adjusted EBITDA margins to 13% in 2025 and beyond as we continue to increase our inspection service and monitoring revenues.

Since becoming a public company, the team has made measurable progress and demonstrated a track record of disciplined, predictable and thoughtful decisions regarding capital allocation, maintaining our focus on tuck-in M&A at appropriate multiples while consistently delivering financial results above expectations across a variable macroeconomic backdrop. We have great confidence in the business and we believe that our laser focus on our long-term 13/60/80 value creation targets will generate outsized investor returns through 2025 and beyond. As a reminder, these include organic revenue growth above the industry average, adjusted EBITDA margins of 13% in 2025, long-term revenues of 60% from inspection, service and monitoring, and long-term adjusted free cash flow of 80%.

We look forward to updating you on the progress in the second half of the year. And with that, I will hand the call over to Russ to talk about the real results.

Russell A. Becker

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

Thank you, Jim. Good morning, everyone. Thank you for taking the time to join our call this morning. Jim mentioned our 13/60/80 long-term shareholder value creation model that you see once again included in our presentation. As I mentioned last quarter, we are relentlessly focused on driving this strategy with our specific focus of achieving 13% adjusted EBITDA margins by 2025. I continue to speak to our leaders about how they can help us deliver on this strategy when I'm visiting our locations around the world. We are aligned as an organization in what we want to achieve and how we make it happen.

During today's call, I will begin my remarks by briefly commenting on our record second quarter results, as well as our continued progress towards delivering on our stated strategic goals in a macro environment that continues to

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be volatile. I will then touch on the long-term organizational investment behind our inspection first model and the benefits it is driving in our financial results. Finally, I'll recap our recent M&A activity and the positive momentum of the business before turning the call over to Kevin who will walk you our financial results and guidance in more detail.

As you've heard me say on prior calls, the safety, health and well-being of each of our 29,000 leaders remains our number one priority. We remain grateful for their hard work and dedication to APi. We believe we have a differentiated approach to leadership development for every teammate at APi, but specifically for our field leaders who interact with our customers on a daily basis. We will always prioritize investing in as many [ph] men and women (00:06:20) 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 only happens when our branches and field leaders are successful. This commitment is one of the foundational principles we believe will continue to enhance shareholder value.

Turning to the second quarter, I'm again pleased with the record results delivered by our global team as we continue to see robust demand for the services we offer across the business. Net revenues grew organically by 7.6% in the quarter and by 9.7% year-to-date, reaching $1.8 billion for the three months ended June 30, 2023, representing the ninth straight quarter of mid-single digit or higher organic growth. Importantly, and in line with our strategic initiatives, we saw a double digit increase in inspection, service and monitoring revenue as we march towards our long-term goal of 60% of total net revenues from inspection, service and monitoring.

US Life Safety continued its strong performance with organic growth of approximately 12% in the second quarter, and approximately 16% year-to-date, led by double digit plus inspection growth, which we have achieved in our US Life Safety business each quarter since the pandemic. In line with our strategic initiatives, we continue to see strong year-over-year improvements in adjusted gross margin in the second quarter, up 160 basis points. I am pleased with the leadership team's ongoing commitment to driving gross margin improvements through pricing activities, drawing higher margin service work and maintaining discipline in customer, project and end market selection.

I want to take a moment to update you on a critical investment we have made over the last decade to become an inspection first organization and how this commitment drives financial results, allows for more disciplined customer and project selection, and helps to build a protective moat around the business. We fundamentally believe that targeting statutorily mandating inspections at existing facilities and providing excellent service on those inspections drives repeatable business and creates sticky customer relationships. When those customers consider expansion plans, we are no longer competing solely on price, but instead can leverage our position as an excellent service provider with our customers to drive higher margin installation opportunities.

We target double-digit quarterly growth in core inspection revenues and we are continuing to build what we believe is the best global inspection sales organization focused on driving this growth. But it comes down to a lot more than just selling the inspection. Inspections are a highly coordinated process requiring field and office collaboration with the customer. This multistep process requires a significant amount of infrastructure and training to do well, as well as the right leaders in the field. We've equipped our field leaders with best-in-class technology and invested in multiple inspection training centers and programs to help develop our field leaders and help enable them to provide great service to our diverse customer base.

Most competitors would rather pursue large installation jobs than the current higher margin, smaller invoice inspection work. Our investment in and commitment to the inspection first model over the last decade is a key

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differentiator and has made growing inspection increasingly within our control. We believe we are ahead of any competitor who would attempt to replicate this strategy and our set investments, sales force and scale have created a large barrier to entry.

As a reminder, in most cases, these inspections need to take place at least once per year or, in some cases, more frequently, and we have data that every dollar of core inspection revenue leads to an average of $3 to $4 of subsequent service revenue. On average, core inspection and service revenue comes in at 10% plus higher gross margins than project revenue.

We included a slide in the presentation that shows the 10-year journey of one of our branches that was an early adopter of the inspection first strategy and its impact on that branch's profitability over time. An underappreciated benefit of continuing to grow inspection service and monitoring revenues beyond serving our customers better is the ability to then be much more selective on the installation work we choose to do, resulting in margin expansion on the project side of the business as well.

For this specific branch, EBITDA margins expanded from low single digits to mid-20% in less than 10 years. You can see the benefit of this approach come through in our consolidated results where we have delivered gross margin expansion for six straight quarters, and an improved quality of the projects in our backlog, which remains healthy and strong. Our leaders continue to execute this strategy across our branch network, and I'm excited for the long-term opportunity in our international business, where we are only in the early stages of instilling this strategy.

The international business continued to show progress, with another quarter of solid growth as we continue to be intentional about targeting only work that is additive to achieving our 2025 13% adjusted EBITDA margin target. The $100 million value capture plan, which is another key contributor to our 13% target remains on track.

Moving on to M&A, 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 in line with our target net leverage range of 2 to 2.5 times. Near the end of the year, are returning to bolt-on M&A. As you may have seen in our July press release, we announced a return to bolt-on acquisitions that are immediately accretive to our adjusted EBITDA margin before synergies. 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. I'm excited to continue to add new businesses and their leaders to the APi family.

We have strong momentum across our global platform as we enter the back half of the year, allowing us to again increase our full year financial guidance. Kevin will provide details on our updated guidance. In summary, while remaining focused on executing in the back half of the year, I am proud of our team and how we delivered on our commitments and produced record financial results so far in 2023. Our field leaders continue to be the driving force of our performance. I'm truly grateful for what each of them has done to get us to where we are today.

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 net revenues for the three months ended June 30, 2023 increased by 7.4% to $1.8 billion compared to $1.6 billion in the prior year period. Net revenues increased organically for the same period by 7.6%, driven by strong organic growth in both Safety and Specialty Services, led by double digit growth in service revenues. In the second quarter, growth in Safety Services segment was

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approximately one-half driven by price and one-half by volumes, while growth in Specialty Services segment was primarily driven by increased volumes, which we measured through labor hours.

Adjusted gross margins for the three months ended June 30, 2023 included 28.3%, representing a 160-basis point increase compared to the prior year period, driven by price increases, outsized growth in service revenues, and project margin expansion across both segments. These factors were partially offset by inflation, which caused downward pressure on margins. Adjusted EBITDA increased by 16.7% on a fixed currency basis for the three months ended June 30, 2023, with adjusted EBITDA margin coming in at 11.5%, representing an 80-basis point increase compared to the prior year period, primarily due to the factors impacting gross margin, partially offset by investments to support revenue growth and the continued build out of our global capabilities and infrastructure.

Adjusted diluted earnings per share for the second quarter was $0.41, representing a $0.04 increase compared to the prior year period. The increase was driven primarily by strong organic growth and margin expansion in both Safety and Specialty Services, partially offset by an increase in interest expense representing a $0.03 headwind to adjusted diluted earnings per share in the quarter.

I will now discuss our results in more detail for Safety Services. Safety Services' reported revenues for the three months ended June 30, 2023 increased by 6.9% to $1.2 billion compared to $1.1 billion in the prior year period. Net revenues increased organically by 7.3%, driven by double digit core inspection revenue growth and robust growth in US Life Safety, partially offset by planned customer attrition in our international business and increased discipline in customer and project selection in our HVAC business.

Adjusted gross margins for the three months ended June 30, 2023, was 32.4%, representing record high adjusted gross margin and a 180 basis point increase compared to the prior year adjusted gross margin, driven by price increases, improved business mix in inspection, service and monitoring revenue, as well as significant improvement in project margins, partially offset by inflation, which caused downward pressure on margins. Adjusted EBITDA increased by 18.7% on fixed currency basis for the three months ended June 30, 2023, and adjusted EBITDA margin was 13%, representing a 120 basis point increase compared to the prior year period, primarily due to the factors impacting adjusted gross margin, partially offset by investments made to support revenue growth.

I will now discuss our results in more detail for Specialty Services segment. Specialty Services' reported revenues for the three months ended June 30, 2023 increased by 7.1% to $555 million compared to $518 million in the prior-year period, primarily driven by double digit growth in service revenues, led by a growth in specialty contracting, infrastructure and utility markets, partially offset by a continued disciplined customer and project selection. Adjusted gross margin for the three months ended June 30, 2023 was 19.1%, representing a 170-basis-point increase compared to the prior-year period, primarily driven by strong organic growth in service revenues, as well as significant improvement in project gross margins, driven by disciplined customer and project selection.

Adjusted EBITDA increased by 15% for the three months ended June 30, 2023 and adjusted EBITDA margin was 12.4%, representing an 80-basis-point increase compared to the prior year period, primarily due to the factors impacting adjusted gross margin, partially offset by timing of some employee-related expenses and other onetime costs. We continue to focus on driving free cash flow conversion improvements year-over-year, progressing towards our long term goal of 80% free cash flow conversion. For the three months ended June 30, 2023, adjusted free cash flow came in at $91 million, reflecting an improvement of $28 million versus the prior-year period, and adjusted free cash flow conversion of 45%.

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For the six months of the year which, as a reminder, is seasonally slower than the back half of the year, we delivered a $75 million improvement in free cash flow when compared to the first six months of 2022. 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 to deliver on our 2023 guidance of at or above 65% adjusted free cash flow conversion, representing an adjusted free cash flow delivery of over $500 million at the midpoint of our updated adjusted EBITDA guidance.

At the end of Q2, our net debt to adjusted EBITDA was approximately 3.9 times even we're to return to margin accretive bolt-on M&A in the quarter. We remain laser focused on cash generation and deleveraging into our stated long-term net leverage target of 2 to 2.5 times, with current expectations to be below 2.5 times net debt to adjusted EBITDA by the year-end 2023. Our balance sheet remains strong with a weighted average maturity of approximately five years, with the earliest maturity in 2026. I will now discuss our guidance for Q3 and full year 2023.

As a reminder, our guidance incorporates the expected impacts of foreign exchange fluctuations, which we expect to be a modest tailwind in the second half of the year when compared to 2022 after being a headwind in the first half of 2023. I'm pleased with the performance year-to-date and the momentum of the business, which gives us confidence to raise our prior full year guidance for reported net revenues and adjusted EBITDA.

We now expect full year reported net revenues of $7.015 billion to $7.075 billion, up from $6.875 billion to $7.025 billion at current currency expectations. This represents reported net revenue growth of approximately 7% to 8%. We now expect full year adjusted EBITDA of $765 million to $785 million, up from $740 million to $780 million, which represents reported adjusted EBITDA growth of approximately 14% to 17%, and adjusted EBITDA margin of approximately 11% at the midpoint.

In terms of Q3, we expect reported net revenues of $1.86 billion to $1.89 billion. This guidance represents reported net revenue growth of approximately 7% to 9%. We expect Q3 adjusted EBITDA of $215 million to $225 million, which represents reported adjusted EBITDA growth of approximately 16% to 21%. For 2023, we anticipate interest expense to be approximately $150 million, depreciation to be approximately $85 million, capital expenditures to be approximately $95 million prior to any potential sale of equipment, and our adjusted effective cash tax rate to be approximately [ph] 24% (00:22:38). We expect our adjusted diluted weighted average share count for the third quarter to be approximately 270 million.

Overall, I'm pleased with the results delivered by our global team in the second quarter and first half of 2023. I look forward to sharing more updates on our progress throughout the year.

I will now turn the call back over to Russ.

Russell A. Becker

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

Thanks, Kevin. As you've heard, APi delivered record financial results in the second quarter and the first half of the year. The business continues to perform well, and we continue to deliver on our commitments. I'm confident in our leaders' ability to generate continued momentum in the business, build on historically strong execution, and consistently drive margin expansion in any macroeconomic environment through increasing high margin inspection, service and monitoring revenue; pricing initiatives; operational improvements; and their relentless focus on customer and project selection.

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As reflected in the increased guidance Kevin just went through, we had strong momentum across our global platform. That part remains healthy. And as planned, we'll continue to focus on the right work for the right customers in the right markets. We believe we can create sustainable shareholder value by focusing on our 13/60/80 long-term value creation targets. As a reminder, these include above market organic growth and adjusted EBITDA margin of 13% plus by 2025. As we look to 2024 and beyond, we have great confidence in the business and the direction we're heading.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Jon Tanwanteng of CJS Securities.

Jonathan E. Tanwanteng
Analyst, CJS Securities, Inc.
Q

Hi. Good morning. Thank you for taking my question. My first one, just on the increased guidance. How much of that is a contribution from acquisitions that you made recently, and any changes in FX? Any color on that would be helpful.

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

Jon, I heard the first part of question, so I'll answer that. The second part, you'll have to come back again. So our most recent acquisitions announced as part of our July release are in our guidance. The impact of that in the back half of the year from an EBITDA standpoint is at or around $2 million.

Jonathan E. Tanwanteng
Analyst, CJS Securities, Inc.
Q

Okay. Great. I was [indiscernible] (00:25:32) contribution as well.

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

FX contribution?

Jonathan E. Tanwanteng
Analyst, CJS Securities, Inc.
Q

Yeah. If any.

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

FX in the back half of the year at EBITDA will be somewhere approximately $2 million to $4 million at currency expectations.

Jonathan E. Tanwanteng
Analyst, CJS Securities, Inc.
Q

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Okay. Great. And then just looking at a little bit longer term, can you talk about the M&A pipeline that you're seeing even with these smaller tuck-ins that you've been doing? Are you seeing more opportunities out there? And is there an opportunity for anything that might be a larger, more accelerated, as you [indiscernible] (00:26:07)? Thank you.

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

A

Thanks, Jon, and thank you for your continued interest in the company. Our M&A pipeline remains really robust. And as we've shared in the past, we've been focused on North America primarily in the US in the life safety space, just partly because we see the same opportunities available to us in our international business. But we remain focused on executing on our value capture program in that part of our business. But the pipeline is really robust.

And I think our company leaders do a really good job of helping us build that pipeline, along with our M&A leadership, inside the company. But there's plenty of opportunities and we continue to look forward to pursuing them and making sure that we add the right businesses to the APi family. On these bolt-on acquisitions, the number one criteria for us is to find the right fit, make sure that we're culturally aligned and we share common values. And when we do that, that's one of the – I think one of the primary benefits that we have as we think about why we're able to acquire these companies at reasonable purchase price, etcetera. So lots of opportunity for us, excited for what the rest of the year is going to bring and potentially in the next year.

Jonathan E. Tanwanteng
Analyst, CJS Securities, Inc.

Q

Great. Thank you, guys.

Operator: Your next question comes from Julian Mitchell of Barclays.

Kiran Patel-O'Connor
Analyst, Barclays Capital, Inc.

Q

Hi. This is Kiran Patel-O'Connor on for Julian. I just wanted to ask on Life Safety. The organic growth there in the quarter and the first half was pretty strong. So I was just curious how much of that organic growth that you've seen year-to-date is market related versus market share gains? Thanks.

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

A

Hi, Kiran. This is Kevin. I would say that, the lion's share of the growth that we're seeing in the US Life Safety business is share gains. We continue to win business through our inspection first model that continues to feed in the service side of the business. But we're going out there and taking business from competition and that's the primary driver.

Kiran Patel-O'Connor
Analyst, Barclays Capital, Inc.

Q

Got it. That's helpful. And the market share gains, is it – I know you talked about the market being very fragmented, is it really smaller players that you're taking it from or are there larger competitors that you're getting these market share gains from?

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

A

I mean, I think it's probably a little bit of both when you think about it, and the key driver for us there is the continued build up and growth of our inspection sales team. And as we continue to build that group out, we will continue to take share. As I mentioned in my remarks, the more traditional way of companies capturing service inspection work is to do the installation work first, and when the installation work is basically 90% complete, they try to approach that customer and sell them on a service and inspection contract.

And we flipped that model on here, and are really, really focused on calling on the already built environment. And that sales force is out pounding the pavement, building relationships with potential customers, and so you're taking that share away from whether that's a large player or small player and it's about having a different approach and a different tactic as we go after that business.

Kiran Patel-O'Connor
Analyst, Barclays Capital, Inc.

Q

Got it. Thank you. And then just my follow-up would be, you talked about strategic pricing initiatives and I was just curious, where are these focus and if you're getting any pushback from customers on them and if there's any churn as a result. Thank you.

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

A

So, I mean, number one, we basically – especially in our inspection and service contracts, we build in price escalation that's typically timed with the price escalation associated with our wage rate and labor increases that come along with it. So we're actively building that price increase into these contracts as we're out selling and pitching them. We have some – and I would say in general, I would say that these price increases have been very, very sticky.

And we have had some attrition, some of these attrition has been on purpose, I would say more of that potentially in the international business. And if you go all the way back to last November, to the Investor Day that we had in New York, and Andrew White made his presentation, he showed 5% customer attrition that, basically, we planned for. Some that would come through price increases because we had poor performing contracts that we needed to deal with the pricing on. We haven't seen 5% customer attrition, it's been probably 2% to 3%, something like that. But, in general, our price increases have been sticky.

Kiran Patel-O'Connor
Analyst, Barclays Capital, Inc.

Q

Great. Thank you.

Operator: Your next question comes from Kathryn Thompson of Thompson Research Group.

Brian Biros
Analyst, Thompson Research Group LLC

Q

Hey. Good morning. This is actually Brian Biros on for Kathryn. Thank you for taking my questions. To start on the – I think contract revenue was called out at high single digits in the quarter at some part of the business. And I think I've heard you talk about as much. Could you just talk about trends in kind of that part of the business? Can we expect solid performance like that going forward or is this more of a onetime event in the quarter?

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

A

Our contract revenue – good morning, Brian. Our contract revenue in the quarter was up organically, but it did not grow at the same pace on the service side. Our contract revenue, just to clarify, was kind of around mid to low single digit growth in the quarter.

Brian Biros
Analyst, Thompson Research Group LLC

Q

Okay. Got it. And then...

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

A

I think when you really talk about the margin expansion on that side of the business, which we continue to purposely moderate growth while we continue to focus on higher margin work with the right customers and the right end markets.

Brian Biros
Analyst, Thompson Research Group LLC

Q

Okay. Got it. And then in the presentation deck, slide 16, nice visual show on the branch growing margins, I think you guys touched on it on the prepared remarks. Can you just maybe bucket out how many branches are either closer at the beginning of that stage or closer to the end of that journey? Just trying to get a sense of how much impact this has going forward versus just the general push for more services.

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

A

I mean, I think it's – I mean, if you look at it from – if you look at it across the entire breadth of the business and you consider this branch, I'll just say fully mature. And then if you think about our international piece of our business, you would say that it's premature. And so, we stretch across the breadth of the business. And if you look inside even North America where we've been focused on the strategy for the last decade or so, we have different levels of adoption inside different parts of our business. And what I can tell you – so, it'd be really hard for me to say that on a scale of 1 to 10, we're at a 5 or 6 or at a 7, because at some places we're at a 10, in some places we're probably at 3 or 4.

But what I can tell you is that basically every one of our business leaders now understands and has embraced this philosophy, and we are actively working to build out that salesforce. As we continue to build out that salesforce, we need to continue to recruit, train and develop the inspectors that can go out and actually inspect, do the inspection work, which is a key component of it and we feel [indiscernible] (00:34:42) service technicians to be able to support that work as well. So, we've got the flywheel turning I would say reasonably well in North America, and it's just starting to turn and probably needs a little more grease in our international business.

Brian Biros
Analyst, Thompson Research Group LLC

Q

Thank you.

Operator: Your next question comes from Andy Kaplowitz of Citigroup.

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Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Hey. Good morning, everyone.

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

A

Hey, Andy. How are you?

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

A

Good morning.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Good. Russ, so, you mentioned US Life Safety still growing low double digits organic. I mean, we talked about inspection, market share gains. I know APi is quite nimble regarding its market focus, but could you give us more color into what end markets are driving that growth? And are there any markets that you are more concerned about in terms of slowing?

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

A

Well, really – thank you. Really, our focus is on data centers, semiconductor, healthcare, I would say to a certain degree higher institution, aviation has finally has really shown some strength, as well as critical infrastructure. And those are really the primary end markets that we keep consistently trying to steer our business leaders to. Obviously, we remain – commercial real estate, everybody's waiting for the shoe to drop there as all of these loans need to be refinanced over the course of the next 12 to 18 months, what kind of an impact [ph] that any of it (00:36:15).

If you're chasing basically developer led commercial real estate projects and that's what you do, that is really dead in the water. And fortunately for us, that's a very, very small piece of our business and the work that we do. And so I feel really good about the end markets that we're in. We can always be better. We can always be more disciplined. But I feel good about where we're at. And I can honestly tell you, like the discipline, Andy, that our business leaders are showing on projects selection, customer selection and end market selection is probably at an all-time high.

And I'm really, really proud of it. And the fact that we're showing on – gross margin expansion is a really a good demonstrator of that. And we could go out and take a lot more seriously project based work if we really wanted to, to accelerate revenue growth, but it would be most likely at the expense of gross margin expansion. And we have been beating and beating and beating the gross margin drop. And it's something that's very important for us if we're going to achieve this long-term target of 13% plus by 2025.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Yeah. That's helpful. And maybe the same question for Europe. You already mentioned customer attrition is lower, but how would you characterize the European markets? Looks like the growth there is a little bit lower in general. Is it still sort of mid-single digits? I think that's what you told us at the Investor Day last November.

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

A

Yeah. I think that's fair. And the one thing that I would just point you to in going all the way back to the Investor Day is that, our international business is actually inspection service and monitoring makes up 60% of their revenue mix. And so just as a generalized statement, the resiliency of that business is really pretty high. And we have continued to see robust demand in the business. And we have seen minimal customer attrition. And the customer attrition we're seeing, to be quite honest with you, is positive for the business and it's going to improve our margins and the performance in the business. So, we're confident in the business and where the business is going.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Helpful. Then maybe one last one for Kevin. Just maybe on price versus cost, Kevin, I think you mentioned price and volume had about a 50/50 split in revenue in Q2. Is that what you would expect moving forward? And with steel coming down maybe a little bit since the spring, does that help your margin at all in the second half of the year?

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

A

Hey, Andy. Yeah. Thanks. So the 50/50 was on the safety side of the business. And I would say, yeah, that's what we're seeing on a year-to-date basis and sort of our baseline expectation as we move through the back half of the year. The material costs, we look at it a little bit, inflation not necessarily all year-on-year, but versus where costs were when we started to propose our business. And the work we worked on in the second quarter was largely work that we were [ph] just talking on the (00:39:39) safety side of the business was work we were proposing sort of late Q4 last year. Versus Q4, we have seen a run-off in material costs in both steel and hot rolled coil. So that creates a bit of a headwind as we work on that. But similarly, as those come down, and it looks like they're going to continue to come down in Q3 in the back half of the year, we should see that margin pick up that we lost on the run-off in the first half.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

Appreciate all the color.

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

A

Hey, Andy. It's Jim. I just wanted to chime in. Martin and I were in Minneapolis earlier this week, meeting with both the international team and the domestic team, and everybody went through their growth plans to get to the 13% plus EBITDA margin. But you said earlier in your questions, lower growth in the international business, I just want to level set people who maybe knew that, remember, most of our international business was acquired by Carrier, and historically, that had negative growth over the last 10 years or so. And so the growth that we're seeing is well within our strategic plan and in line with making sure that we're spending behind the right initiatives. But we couldn't be more pleased with the performance of the international side of the business. It's measured and balanced and thoughtful growth as compared to its historical performance.

Andrew Kaplowitz
Analyst, Citigroup Global Markets, Inc.

Q

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Appreciate the additional color, Jim.

Operator: Your next question comes from Chris Snyder of UBS.

Chris Snyder
Analyst, UBS Securities LLC

Q

Thank you. So organic growth in the first half of the year is kind of hanging around this low double digit level. And it feels like, ultimately, the drivers of the business are regulation and also share gains, which is still long lasting and really not macro dependent. So with that, what are the drivers or the headwinds or just the normalization that's going to push the organic growth from the low doubles to the kind of the more mid-single digit normalized levels? Is it the project selection that you guys have been talking about?

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

A

100%. And we've been very purposeful in the installation work in our HVAC business in trying to make sure that we're selecting the right opportunities to pursue, as well as in our Specialty Services segment, just as a whole. And as I mentioned earlier, like, I'm really proud of our team for the discipline that they're showing in making sure that we're pursuing the right opportunities and I think it's making a difference.

Chris Snyder
Analyst, UBS Securities LLC

Q

Thank you for that. And then for my follow-up, I wanted to maybe ask about the two – or the bolt-on that the company talked to in the preannounced last month. I guess, what kind of surprised us was that you guys said these transactions are immediately accretive to EBITDA margins despite obviously being kind of smaller businesses. Can you just maybe talk a little bit about that? And is that what we should expect on all bolt-ons, or is there something unique about these that are coming on at EBITDA margin premium? Thank you.

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

A

Well, I mean, the bolt-ons that we've recently executed, when we talk about it being immediately accretive, their performance is at an EBITDA margin that's currently higher than [ph] fleet average (00:43:26) at APi. And so, you make the assumption that they're going to continue to perform where they're at. We're going to start to integrate those businesses very quickly, and hopefully continue to improve their margin performance, which has been a really big part of our model. So from day one, those businesses will be accretive making that assumption.

I would say that in general, I mean, that's our focus. We want to – as we've continued to acquire companies, we want to acquire companies that are accretive, right? Does that mean that we're willing to acquire, say, a business that's in a geographic area that maybe the performance of that business is only 11% or 12% on a pre-synergy basis? If it was in the right geographic area, it met all of our criteria from a culture and values and fit and we could see a clear path to how we can get that business performing at, say, 15% on an EBITDA margin, we would certainly look at doing something like that.

So a lot of these businesses, just to be totally honest with you, Chris, when we acquire them, they might tell you that their inspection service and monitoring is 35%, 40% of their total revenues. And usually when you start digging in, you find out that it's less than that. We have a very clear road map and playbook on how we can take those businesses, get that inspection first mindset instilled in the business and get it moving forward very quickly, get it on the right glide path. And so, geographic, looking at the map and looking at geographic expansion, it's

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complementary to our existing footprint. It's something that's important for us as we – and especially important for us as we continue to try to broaden our base of national accounts, so. But we're not going to – we're not out actively looking for poor performing businesses or anything like that by any stretch of the imagination.

Chris Snyder
Analyst, UBS Securities LLC

Q

Appreciate that. Thank you.

Operator: [Operator Instructions] Your next question comes from Andy Wittmann of Baird. Your line is open.

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

Q

Hey, Russ. So I guess my question is just, given the relative growth rates between your inspection service and monitoring business that's the flywheel that you're really focused on growing so well, and the project business where you're being so selective, are you having to move personnel to the inspection side of the business from your project side of the business given the tight labor markets? Can you just talk about how you're staffing this growth on that inspection side?

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

A

Yeah. So that's really a separate workforce, Andy. Good morning, by the way. It really is a separate workforce. And what we've done is we've continued to build out that inspection sales force. We've set up centers of excellence inside the Life Safety business to train, so to speak, I'll say, our new and future inspectors as we continue to recruit. And as we build that inspection sales force, we need to build our inspector sales force that's going to actually execute the work. And we have to be able to train those men and women.

We have other centers of excellence as well. Like, we have a design center of excellence where we do design overflow and we train designers. We have – one of our businesses had developed accredited apprenticeship program for [ph] fire line (00:47:20) technician so that we can make sure that we're not letting that skilled technician need become a bottleneck for us. But it's really a separate workforce.

And if you're really going to have a robust inspection service and monitoring business, they need to be segregated. And in general, the people that are doing your installation work, they really want to do installation work. And most of them don't want to do two small jobs every day with different customers and moving around in a van. They just have different – they have different interests. But keeping them separate is very important.

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

Q

Okay. That makes sense. And I guess for my follow-up, Kevin, for you, could you just give us an update on the cost capture plans and their status? Maybe talk about how much cost do you expect to incur in the second half of the year, maybe the run rate of cost capture synergies that you've exited the second quarter and how you're tracking for exiting this calendar year as you head into 2024 in those cost captures?

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

A

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Sure. Good morning. So from a expense standpoint, our prior guide of $55 million to $65 million in the year is still our expectation for full year 2023. As a reminder that on the back of $30 million that we had in 2022. We talked about the 2022 charge of $30 million should accrue to the P&L on one for one basis for savings. We still expect that in the year to be between $20 million and $25 million that we expect to accrue from a savings standpoint from last year's charge. This year's charge will be back-half loaded, but we expect to see some savings there probably somewhere between zero and $5 million, so approximately $5 million of additional savings from our 2023 activity in charge.

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

Q

Thank you.

Operator: Your next question is from Steve Tusa of JPMorgan.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Hi. Good morning.

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

A

Good morning.

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

A

Good morning, Steve. How are you?

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Not too bad. Congrats on the strong cash flow in the quarter.

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

A

Thank you.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

The commercial exposure you guys have, I think it's like 19% of sales or something like that. How much of that is office? And then looking at that telecom and utilities bucket, is that like telecom – is that mostly telecom or is that – I'm just trying to figure out what part of it is the actual like, maybe power, energy, utilities bucket. It seems like you have a transmission piece of the pie as well. Just curious on those two parts of the pie chart.

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

A

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So in the commercial bucket, I would say a very small amount of that is sort of the high rise that you're talking about. We estimate that it's inside of 5%. The remainder would be the end markets or the areas that you're referencing, being telecom and some of those other areas.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Great. And then just a little guidance on the segment sales forecast for the second half, just organically, how you expect those to trend. Are those pretty stable or accelerating or decelerating? And [indiscernible] (00:51:09).

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

A

Yeah. No problem. We're not guiding to specific segment breakouts in the back half of the year, but what I'll tell you is sort of, our specialty businesses, we've done a good job of managing growth as we planned focusing on the right end markets and the right customers and driving gross margin expansion. And obviously, we've talked a lot about the safety businesses and US Life Safety business and the performance we saw there in the first half. I would say, if you look at our back half, those are similar expectations. We're going to continue to moderate and manage growth from the Specialty Services side and we're going to continue to capture organic growth and share gain on the safety side.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Great. Thanks a lot.

Operator: And there are no further questions at this time. I'd be happy to return the call to our hosts for any concluding remarks.

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

Russ, it's Jim. Can I just jump in on one thing before you do your concluding remarks, please?

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

Sure.

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

So, there's been a lot of conversation on the call today about M&A. So I just want to clarify, the return to focus on the tuck-in deals, we think that we can live well within our leverage targets while staying more focused on these smaller acquisitions, so much so that when we were in Minneapolis this week, we talked about ramping up the spending and likely doubling it as we move into 2024 and still doing thoughtful tuck-in M&A, considering larger ones as they come across our desk because we want to remain educated on what's out there in the world. But the real focus in the near term is on these tuck-in deals that Russ and the team have just done so well, historically, paying appropriate multiples for them. And as I said earlier, I believe we can ramp up our spending on that and still live well within our debt to EBITDA ratio goals.

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So, with that, Russ, I'll turn it back over to you. Thanks.

Russell A. Becker

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

Thank you, Jim, for the color. In closing, I would like to thank all of our team members for their continued support and dedication to our business. We believe our people are the foundation on which everything else is built. Without them, we do not exist. I'd 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 we 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. And to all of our APi teammates across the globe, please know that we're grateful for everything that you do to help us win in this environment. Thank you.

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

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