2022 SECURITY MEGATRENDS™

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MEGATREND 4

SERVICE MODELS AND THE CLOUD

THE "MOVE TO SERVICE MODELS" and "cloud computing" have long been included in SIA's annual Security Megatrends report as separate trends, but for 2022, based on input from survey data and commentary during Securing New Ground, we're officially connecting these two megatrends.

"The move to service models has been kind of concomitant with the move to the cloud," explains Steve Van Till, Brivo's president, "but really it [service models] is a business concept as opposed to a technical concept [cloud computing]." The fortunes of these two trends have often been tied together, and one way many firms have been able to move to as-a-service/recurring revenue models has been by delivering solutions in the cloud.

Today, this is a trend that nearly all companies in the industry are exploring, and it's becoming uncommon to see a startup company launch without a subscription delivery model and some element of the cloud, whether it's a solution delivered entirely via the cloud or whether the system uses the cloud for some processing or storage.

PERSPECTIVES

"I basically say, 'Listen, you're talking about owning and renting. You have a car; you either own the car or you lease the car.' So that's the only thing we're changing on you is that you're now leasing a product that's at your site, whether it's an NVR, DVR or a camera in our video world. And you're going to pay for that on a monthly basis or a yearly basis, instead of buying it one time, so it's OPEX versus CAPEX. And again, do I want to lease the car or do I want to own a car and deal with the maintenance? And that's typically what an IT guy understands. It's the security people that grew up in the industry [before service models]; they're the ones that are confused about [this change to a service/leasing model]."

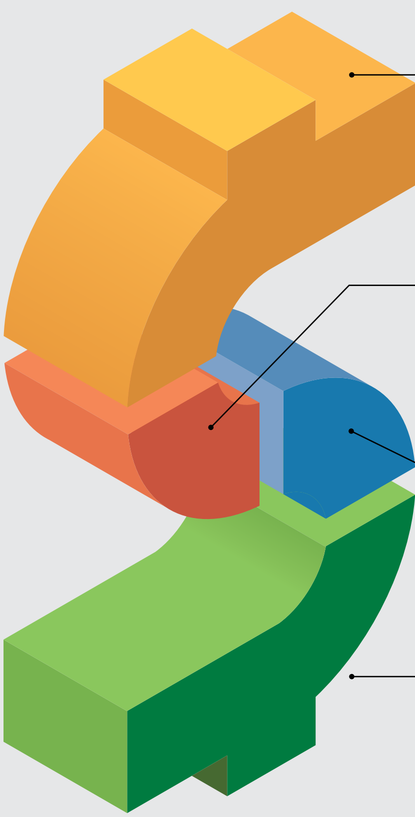
– Tom Cook, Executive Vice President of Sales & Operations, Hanwha Techwin America

"There are clearly much higher valuations for companies with recurring revenue models. Witness that security integrators with mostly one-time install revenue will trade for 0.5 - 1.5x revenue while recurring-revenue-focused alarm companies will trade for 3 - 5x annual recurring revenue or ARR. And then in the high technology SaaS businesses which are heavily recurring revenue focused, you can see revenue multiples of over 10x."

– John Mack III, EVP, Imperial Capital

SERVICE MODELS AND COMPANY VALUATIONS

Imperial Capital's John Mack III says the key variables for recurring revenue businesses to trade at higher multiples include the following attributes:



1. **Reasonable investment level to create new customers.**
   "In the alarm industry this is called 'creation cost.' In the SaaS world, this is measured with a metric known as LTV/CAC, long-term value creation/customer acquisition cost."

2. **Good gross margins for the recurring services.**
   "Typically, at least 60% but more like 70%+ and for the high technology SaaS businesses, in many cases 80%+."

3. **Low attrition (10% or less) or high retention (90% or better).**
   "In many cases, with new services sold to existing customers there is net growth in recurring revenue or net retention over 100%."

4. **High growth rates.**
   "Rates of at least 10%+ in recurring revenue per year and for the high valuations growth, rates in the 25%+ range or much higher."

AS-A-SERVICE MODELS, NOT JUST SERVICE AGREEMENTS

Service models do not equal service agreements stresses PSA Security Network CEO Matt Barnette. Typically service agreements were a small addition on top of a one-time project-based fee. And while service agreements are a step in the right direction for integration companies looking to transition to a recurring revenue model, the real change comes when the former project-based fee is transformed into a recurring charge.

BETTER FOR BUSINESS

At SNG, Luis Orbegoso (who today leads Allegion in the Americas) tells the story of when he worked at ADT and the company made the switch to the cloud for delivering video solutions: "We actually stopped selling DVRs for the most part; [we] put all the video in the cloud. [It] drove a huge amount of retention. It was a better business model. It was easier to sell because it was less of a capital expenditure."

UPTIME, EVEN DURING BAD TIMES

As the COVID-19 pandemic sent workers home, it sent company CTOs scrambling to ensure systems remained available, whether the worker was in a cubicle on office floor 7 or working from their dining room table or a corner of their bedroom. Cloud solutions naturally exploded in popularity.

GENERATIONAL CHANGE TO RMR

Chris Meiter, president of Salient Systems, tells the story of changing from perpetual licensing to a subscription model.

"We're seeing a major transition from what we classify as the perpetual licensing agreement, to a subscription-based model," said Meiter. "The customer sees the value of the upgrades and things that come with that subscription model on an annual basis. But as we first rolled this out, we actually had some pushback by some of our integrators that were like, 'Hey, I've been selling perpetual, and we don't see the value in subscription-based.' It was literally this one company, a 50-year-old company, which had been selling perpetual licenses forever.And that was the first generation of the company speaking to us, but all of a sudden, the second generation says, 'Hey, wait. We want to build the value of this company. We want to have more equity value in this company. You can't do it just with a one-and-done sale. You need to do it with a recurring model.' And they ran that through their CFO and they could double- or triple-increase their company's value within two years by moving from perpetual licensing to subscription-based software. So, the message is getting out there and they're seeing the value."

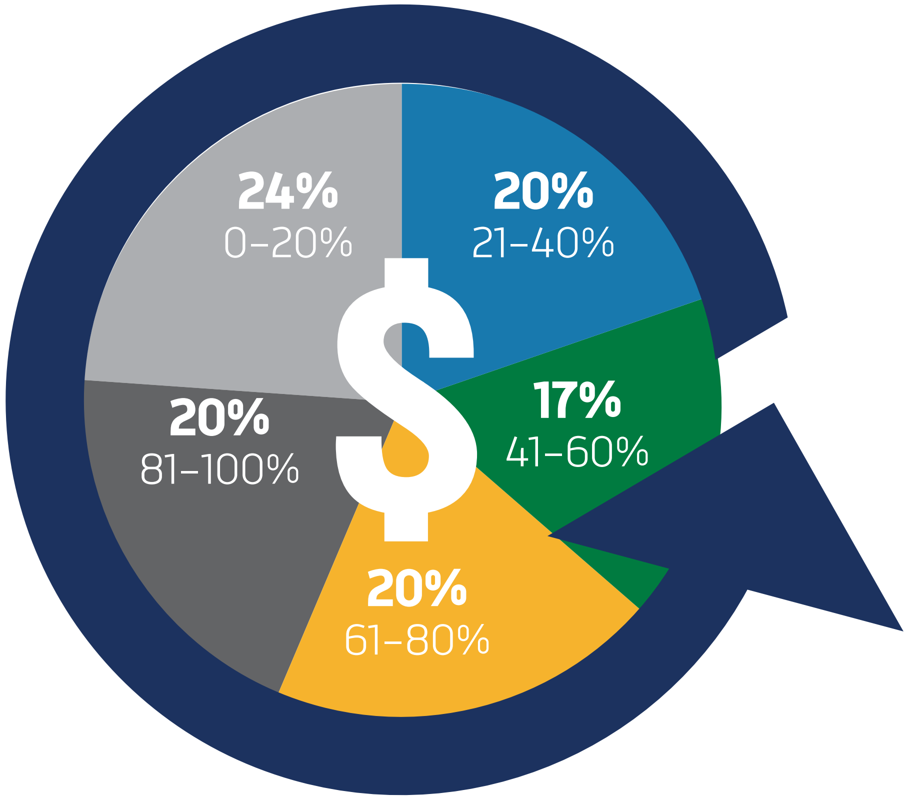
50%
Percentage of corporate data now store in the cloud
Source: Statista

98%
Percentage of companies that had at least one cloud data breach in the past 18 months
Source: IDC

SNG POLL

WHAT PERCENTAGE OF YOUR FIRM'S TOTAL REVENUE IS FROM RECURRING REVENUE?

Business models continue to shift. A year ago, over a third of respondents said that less than 20% of their firm's total revenues were attributed to recurring revenue. A year later, that number had decreased to less than a quarter of respondents, indicating that companies were steadily transforming their business revenue from one-off sales to recurring, as-a-service income streams.



MEGATREND MOVEMENT

A long popular Megatrend, the move to service models had ranked #5 in 2017 and 2018, falling to #7 in 2019, #9 in 2020 and #10 in the 2021 report. Meanwhile, cloud computing had seen its ranking steadily climb, but the jump into the #4 position for 2022 reflects both the effect of the pandemic and conjoining of what were previously two separate megatrends.

TAKEAWAYS

Investors, equity firms and even companies making acquisitions continue to deliver higher valuations to companies which are heavily invested in cloud services and recurring revenue.

Companies with software services or access to data services can make the cloud and recurring revenue business model transition easier than hardware-only type companies.

Security end users requests for anywhere, anytime access to security solutions will further advance cloud adoption.

Many formerly "on-prem" software-and-server based security solutions now are configured to run on common cloud infrastructure platforms from firms like Amazon Web Services, Google and Microsoft.

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