



Stern IAG

October 26th, 2018

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Price Target: \$10.64 (43% upside)

Agenda



1. Executive Summary



2. Situational Overview



3. Investment Thesis



4. Catalyst and Risks



5. Valuation

Executive Summary

We recommend that Investment Analysis Group take a position in ADT under the condition that the Company 1) continues to expand its commercial security business, 2) further increases free cash flow yield by improving key operating metrics, and 3) remains focused on deleveraging the business

Investment Thesis Summary

1. ADT is the leading provider of monitored security, interactive home and business automation, and related monitoring services with a variety of strong, improving operating metrics
2. Strong brand recognition and superb customer support / monitoring provides ADT with the ability to charge premium prices for services – even in the face of DIY and reduced price security services
3. Experienced management team with extensive background in the security and technology industry focused on improving long-term cash flow generation
4. Significant opportunities for ADT to acquire additional residential and commercial market share through the creation of new / expansion of existing products and services
5. Artificially depressed stock price as the result of overblow concerns in regards to debt refinancing presents great buying opportunity for Investment Analysis Group

II. Situational Overview



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Industry Overview

Rapidly Growing Industry

- **Total Addressable Market**
 - Estimates suggest that by 2020 the Global Market for Security is supposed to pass \$100 Billion Dollars
- **Seasonality**
 - More households moves take place between April and end of September
 - This effect new customer installation volume and cash expenses incurred in investments in new customers

Consolidating & Competitive

- **Highly Competitive and Consolidating Industry**
 - Johnson Controls International.
 - Vivint, Inc.
 - Stanley Security Solutions
 - Stanley Black and Decker
 - MONI
 - Subsidiary of Ascent Capital Group, Inc.
 - Comcast Corporation
- **Large Technology companies are moving into the space**
 - Amazon Smart Home Security Packages

Smart Homes

- **Smart Homes**
 - Term used to define homes with appliances such as lighting, heating, air conditioning, TV's, etc. that are connected remotely
 - Estimated to pass 41 Billion Dollars in 2020
 - Companies like Amazon are entering this industry
 - Using Personal Assistant devices like Alexa to connect and set daily schedules

Business Overview

Industry Leader in Providing Home and Commercial Security Services

- **ADT is currently the largest security provider in United States and Canada**
 - 7.2 million residential and business customers
 - 24/7 monitoring network
 - 18,000 employees
 - 15 million alarms annually
- **Leading provider of monitored security, interactive home/business automation**



Competitive Edge

- **Competitive Edge**
 - Competition is usually based on price
 - ADT competes using better customer service
 - Uses its recognizable brand to earn over customers
- **Patents/Trademarks**
 - Actively enforce intellectual property
 - Heavily enforced especially in the US and Canada
 - The Blue Octagon and ADT are owned in all territories outside the US and Canada

1Yr Stock Price Performance



Business Overview

ADT Acquisitions

- **ADT Acquired by Apollo Management in 2016**
 - Apollo had already acquired security companies Protection 1 and ASG in 2015
 - ADT upon acquisition began merging with Protection 1 and ASG
 - Many ADT managers and executives transferred over from Protection 1
- **ADT has made past acquisitions of other companies and continues**
 - Broadview (Brinks)
 - MSE
 - Commercial Security focused on enterprise/business
 - Gaston
 - Video Integration and Surveillance Company
 - Datashield
 - Internet and Network Security Company

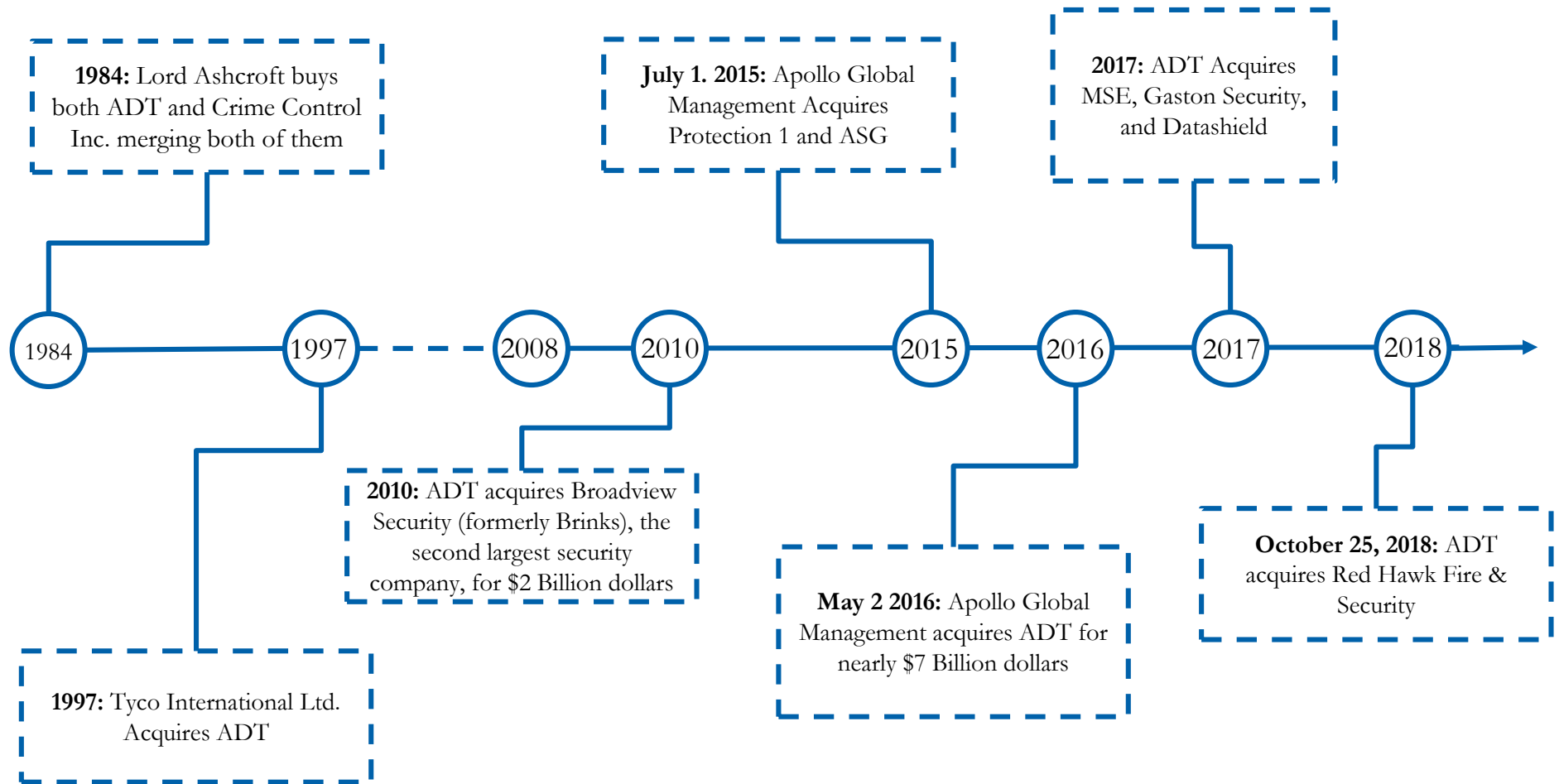


Amazon Partners With ADT

- **ADT Pulse Security System**
 - Accessible from Mobile App
 - Combines Home Automation and Security
 - Compatible with Amazon Alexa
- **Amazon Offers their Own Security System Packages**



Acquisition Timeline



Business Services

Most of ADT's monitoring services and a large portion of their maintenance services are governed by multi-year contracts with automatic renewal provisions that provide the firm with **contractually committed recurring monthly revenue**

Traditional Segments



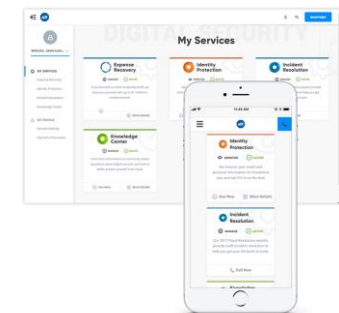
- Monitored Security Systems for residential and commercial customers, designed to detect intrusion, control access, and react to movement, smoke, carbon monoxide, floor, temperature, and other environmental conditions and hazards
- Equipment Installation and Maintenance Services
- Customer Support and Monitoring Centers

ADT Pulse



- Accessible Mobile app that combines home automation and security together in one-platform
- Enables users to remotely arm / disarm alarms, remotely lock / unlock doors, interact with lights, thermostat, garage door, and doorbell, and show live video feed of house
- Compatible with Amazon Alexa, Amazon Ring, Google Home, and other security systems / devices

Digital Security



- **Identity Protection:** provides monitoring and support to help customer minimize their risk of identity theft by enabling customers to track their credit report activity, change of address notifications, etc. with 24/7 fraud incident resolution and identity theft reimbursement
- **Future Offerings:** Dark Web Defense, Secure VPN, and Home Protection Network

III. Investment Thesis



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Investment Thesis

1.

ADT is the leading provider of monitored security, interactive home and business automation, and related monitoring services with a variety of strong, improving operating metrics

- 2017 Gross Margin of 79.2%, up from 76.5% in 2016, and 2017 EBITDA Margin of , up from in 2016
- Typical 3 to 5 year customer contracts improve customer stickiness and provide stable, forecastable cash flows

2.

Strong brand recognition and superb customer support / monitoring provides ADT with the ability to charge premium prices for services – even in the face of DIY and reduced price security services

- ADT's brand is recognized as the #1 home security company⁽¹⁾
- \$50 million of additional earned revenue (1.2% of total 2017 Revenue) between 2016 and 2017 was driven mostly by the addition of new customers at higher rates (result of high quality customer acquisition)

3.

Experienced management team with extensive background in the security and technology industry focused on improving long-term cash flow generation

- Management team has drastically improved margins, along with other operating metrics, less than 24 months into their tenure at the combined ADT entity
- Management performance is tied to key industry / business KPIs

4.

Significant opportunities for ADT to acquire additional residential and commercial market share through the creation of new / expansion of existing products and services

- Even though ADT is the market leader in residential home security, they only serve ~7 million households out of the >126 million households in the United States (2017) – showcasing a large runway for additional value
- 7 acquisitions in the commercial security space to bolster Company's B2B security competencies

5.

Artificially depressed stock price as the result of overblow concerns in regards to debt refinancing presents great buying opportunity for Investment Analysis Group

- As of October 24th, 2018, ADT's stock is down 52.6% from its initial IPO Price of \$14.00
- Compared to its peers, ADT is trading at favorable metrics for a value-oriented play with an EV / EBITDA LTM of 7.0x and P/ Diluted EPS LTM of ~15.0x

1. Strong Operating Metrics

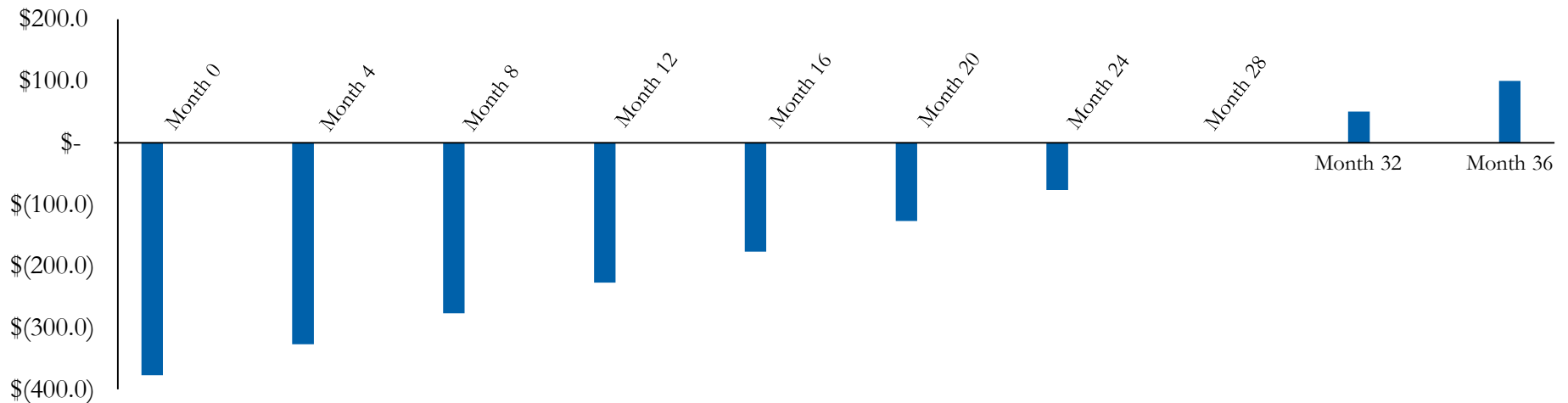
Improving Revenue Payback

- **Business Mix:** improving commercial has better payback
- **Variance Performance Management:** drives productivity and higher install revenue per job
- **Vendors:** secure lower cost equipment given quantity buying
- **New Technology:** marginally reduces install time
- **Upfront Revenue:** drives more rev. collection at $T = 0$

Revenue Payback Explained

	<u>Q2'17</u>	<u>Q2'18</u>
Selling & Advertising	\$136	\$139
Installation Cost	\$355	\$139
Installation Revenue	(\$114)	(\$156)
Total Net SAC	\$377	\$367

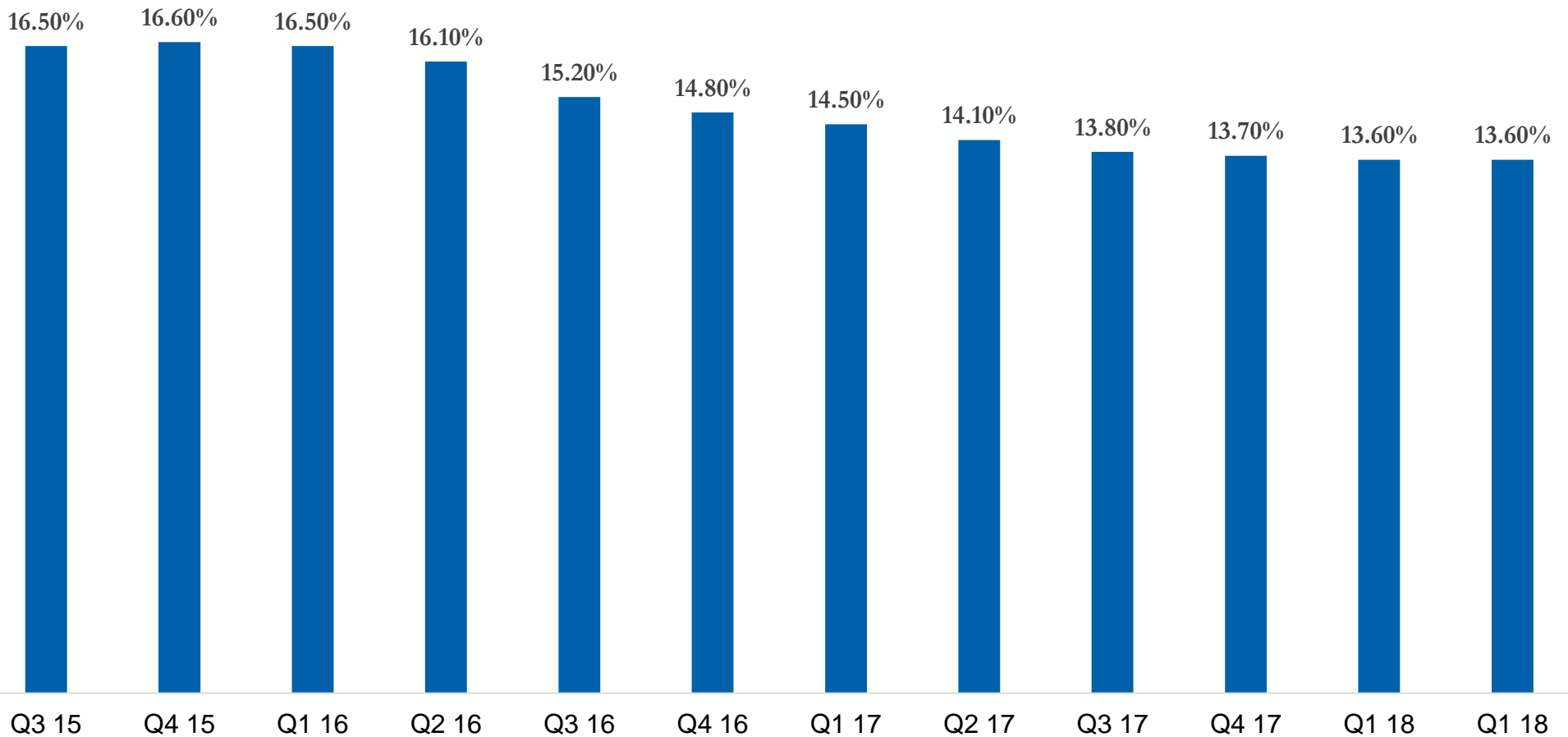
Breakeven Point Analysis, Current Customer Base



1. Strong Operating Metrics (cont'd)

Churn looks to be stabilizing under new management and it matters: every 100bps of gross revenue attrition improvement drives ~100M of additional cash flow

Existing Customer Retention: Trailing 12-Month Gross Revenue Attrition



2. Brand Recognition

“New entrants cause you to rethink who you are as a brand. As consumers have gotten more educated, that has required us to rethink where we want to play – and how a changing consumer perception impacts us.”

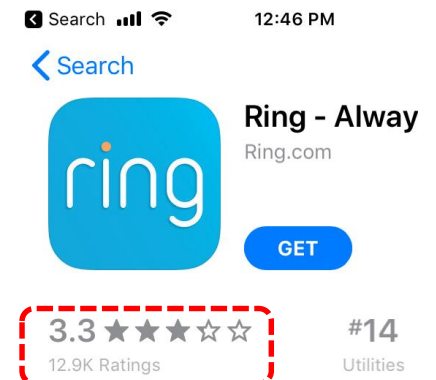
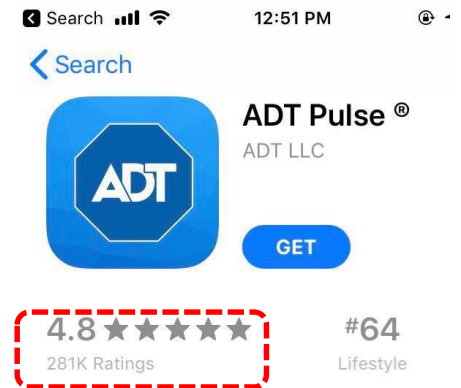
-Tana Barton Haas, VP of channel and product marketing at ADT

Brand Recognition

- ADT brand recognition is one of their highlighted strengths
 - ADT uses their superior and higher-quality brand name to stand out from their competition
 - Actively enforces the trademark and Brand (including the blue octagon)
- Owned or Licensed in all territories outside the US and Canada
 - ADT gives customers signs to put up showing the ADT brand
 - ADT’s IPO grossed 1.47 Billion dollars
 - ADT sold 105,000,000 shares at IPO price of \$14.00 per share

Awards

- Won “Installer of the Year” and “Integrated Installation of the Year” Awards for Commercial and Multi-Site Security at 23rd Sammy Awards
- The Sammy Award is an industry standard for Home Security
- Protection 1
 - Won “Best Overall Integrated Marketing Company” “Best TV Advertiser” “Best Community Outreach Program” and “Installer of the Year” all in 2014
 - The same PR and Customer Service Manager now works in the same position at ADT



3. New Management



Timothy J. Whall

CEO of ADT and Protection 1 following the two companies merger in 2016. Previously owned and operated Conder International and Central Security. Was COO of SecurityLink. Founded his first security company in high school. Was CEO and COO of Stanley Convergent Security Solutions



Jeff Likosar

CFO, Treasurer, and Executive Vice President of ADT. Previously held the same offices at Protection 1. responsible for leading ADT's financial strategy to help drive profitable business growth, streamline integration efforts and identify synergies as ADT and Protection 1. Also served at Gardner Denver Holdings Inc., Dell, and GE across the plastic and appliances division.



Jamie R. Haenggi

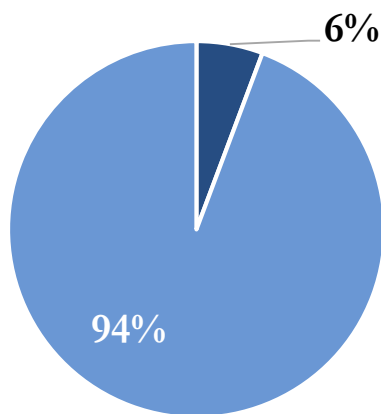
Chief Sales & Marketing Officer and CCO (Chief Customer Officer) at ADT. Has over 20 years experience in marketing the Security Industry. Previously served as CMO at Vonage and Protection 1. Under her tenure at Protection 1, the company won several PR and Customer Service awards.

4. Growth Initiatives – New Services in a Large Addressable Market

Digital Security

- **Upselling Current Customers:** provides the company with significant upsell potential by getting existing customers to purchase internet / network security services on-top of their current home security plan
- **Attracting New Customers:** Prospective customers 1) who recognize ADT's brand name for security and 2) are current seeking digital security solutions or bundled solutions are likely to purchase services from the Company

Large Runway for Additional Value



- Even though ADT is the market leader in residential home security, it only serves ~7 million of the 126.22 Million Households that exist in the United States (2017)

ADT Pulse Partnerships / Licensing

- Alexa Guard leverages ADT Pulse technology so users can send Smart Alert audio clips to ADT's response network– **showcasing the value ADT has in its robust first responder network**
- In the future, ADT could license the use of its response / monitoring network to DIY solution providers to generate revenue off of non-target consumers



4. Growth Initiatives – Expanding Commercial Consumer Base

ADT's planned expansion into commercial and multi-site security – a \$15 to \$20 billion dollar market – will 1) significantly bolster the company's top line growth and 2) increase **the Company's moat against growing threats from Amazon** and DIY security solution providers

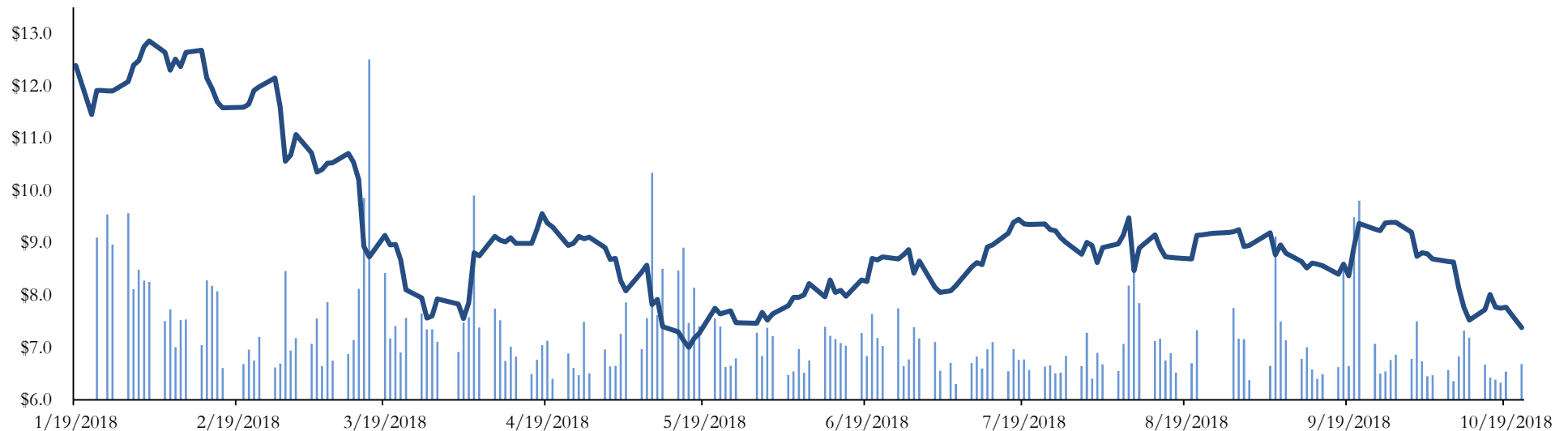


Expanding Commercial Consumer Base

- **Stronger Customer Profile:** Commercial customers tend to be more sticky than residential, providing ADT with more stable, forecastable cash flows and less customer churn. Additionally, commercial customers tend to have shorter payback periods than residential and are more willing to purchase and own the security infrastructure – rather than ADT having to own the installed devices
- **Higher Barriers to Entry:** Competitors such as Amazon, Google, and DIY security service / product providers are more focused on the residential security market rather than the commercial due to higher barriers to entry – such as having an extensive first responder network - and minimal B2B interest in DIY security devices / services
- **Acquired Industry Knowledge:** ADT acquired Protection 1, Aronson Security Group, Acme Security Systems, Access Systems, and Secure Designs through tuck-in acquisitions to expand ADT's commercial capabilities – leveraging each firm's strategic competences in commercial security systems to bring value to potential B2B customers



5. Repressed Stock Price Establishes Potential Buying Opportunity



Strong Inst. Ownership

- 99.9% of shares are held by a variety of value and long-focused institutional investors
- Apollo, ADT's primary sponsor, still holds ~84% of the common shares
- Current short interest for ADT's common shares is less than 5%

Lack of IPO Pop

- ADT's current price per share, \$7.50 as of 10/25/2018 close, is ~50% under the stock's initial IPO price
- This current price per share discounts the value of ADT from when Apollo first purchased it in 2016 by 20%

Trading Metrics

- ADT is current trading at a LTM P/Diluted EPS Multiple of ~15.0x and a TEV / EBITDA LTM Multiple of 7.0x – well-below its competitors
- Additionally, the Company has a NTM Forward P/E of 8.03x

VI. Catalysts & Risks



Catalysts



**Strategic
Acquisitions**



**Growth of Sales
Team**



**Improved Free Cash
Flow Yield**



**Increased Interest in
Smart Homes**

Investor Concerns

Fragmented, numerous competitors offering reduced prices for similar residential security options have the potential to commoditize standard security offerings

Pricing Pressure

- ADT's strong brand recognition and trusted monitoring / customer services enables the Company to charge premium prices for its products and services
- The Company is also expanding into the commercial space

Brands such as Ring, Arlo, and Nest are providing consumers with low cost, easy-to-implement, do-it-yourself security solutions

DIY Solutions

- Costs add up quickly when customers want to add multiple devices since each device within itself does not offer a comprehensive security package
- These providers partner with ADT, mainly through ADT Pulse, because they lack the response network

New security start-ups may innovate faster than ADT, creating products / services that will steal market share

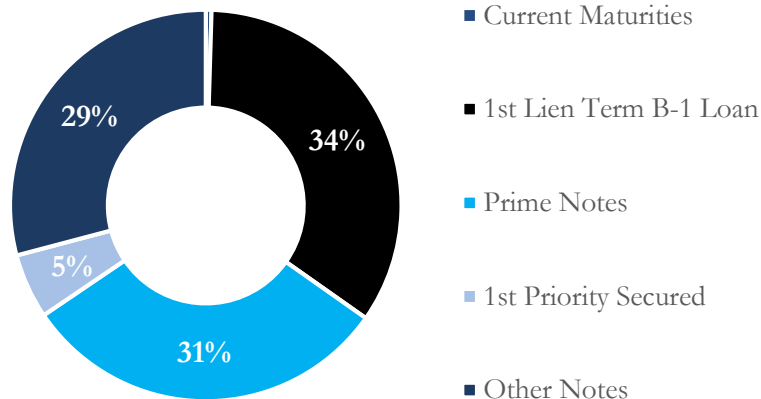
Technology Innovation

- ADT is currently investing significant capital in innovative solutions (i.e. Pulse and Canopy)
- The Company has also partnered with Plug and Play Tech Center in order to partner with / invest in innovative security tech start-ups

Investor Concerns (con't.)

Significant Debt Burden

- Debt covenants established by the Koch Brothers limit the amount of cash that can be allocated to investors via dividends
- Current debt obligations can potentially limit cash flow that can be used for investing into the company
- Some Investors are concerned that possible interest rate hikes could make ADT's debt more expensive (*Increased risk of default*)
- The average bond rating for ADT's notes is BB-, a rating associated with Junk Bonds⁽¹⁾



Other Risk Factors

- **Reputational Risk:** as an industry that is founded on trust and consumer confidence, lapses in ADT's ability to address emergency situations and service its clients may damage its reputation – making it harder to acquire new, high-value targets
- **Integration Risk:** much like any company that is growing its scale and services through acquisition, ADT may experience diseconomies-of-scale, reduced top line growth, and a bolstered cost profile if the variety of acquired commercial security companies are not integrated properly



V. Valuation



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Notes and Debentures Outstanding

Issue	Outstanding Balance	Coupon Rate	Annual Interest Expense
First Lien Term B-1 Loan Due 2022	3,500.6	4.500%	157.5
Prime Notes Due 2023	3,140.0	9.250%	290.5
4.875% First-Priority Senior Secured Note due 2032	547.8	4.875%	26.7
5.250% Notes Due 2020	313.5	5.250%	16.5
6.250% Notes due 2021	1,050.0	6.250%	65.6
3.5% Note Due 2022	940.5	3.500%	32.9
4.125% Notes due 2023	651.0	4.125%	26.9
4.875% Notes Due 2042	16.5	4.875%	0.8
Revolving Credit Facility	0.0		
Total	10,159.9		617.3
Average Interest Rate	6.08%		

	2018	2019	2020	2021	2022
Net Income	-189	-166	-131	-65	85
(+) Depreciation and Amortization	2050	2255	2480	2678	2893
(-) Capital Expenditures	-701	-771	-848	-916	-989
(-) Change in NWC	-10	-10	-10	-10	-10
Unlevered FCF	1150	1307	1491	1687	1979
(-) Debt Payment	0	0	314	1050	4441
Levered FCF	1150	1307	1178	637	-2462

Levered FCF Multiple	7
Implied Market Cap	8050
Shares Outstanding	757
Implied Share Price	11
Current Share Price	7.46
Implied Upside	43%