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<u>Interview transcript</u>

Question: How is the market structured? Can we speak of a fragmented nature or a consolidated nature?
Answer:

Our commentary will be very UK-centric. So that's worth putting in perspective. And the second thing is when you say fire safety equipment, I think it's just worth making clear that we would be talking from the perspective of the services, as in the installation the inspections, the maintenance, those sorts of aspects, not the manufacturing side per se.

First off, it's very different when we talk about manufacturing or services. But at the services level, which is indeed, once again, design, installation, maintenance, ongoing stuff, and then it's all very, very, very fragmented. At the end of the day, we probably have the top ten providers making up maybe a third of the market, but then there'd be a very long tail of hundreds and hundreds of providers. And if you just do a pure bottom-up in the UK alone, I think there's a bit over a thousand providers in total. Now, some of them are obviously very, very small, but it just shows how big of a tail there really is here in this market. And some of the bigger providers would include well, Chubb, ADT, and Johnson Controls would be the big names in the space.

But you do also have several second, not second tier, but the next level down in terms of size, which would then be more the likes of TSG, Marlowe, Churches, Trinity. So there's quite a few others as well, and then there's a very long list of names, but very fragmented would be the short answer.

Question: What is the reason for this fragmentation?
Answer:

This is a supply side element, which is quite easy to enter. Actually, you start to see that a lot of individual fire engineers can develop their own proposition and start serving local customers and then expand it into three or four person organisations. And then beyond from there. there's also, I think, the nature of the OEM market, the fact that the OEMs do a lot of the inspections themselves, but tend to do inspections on their own equipment. I think that opens a door for people who have multiple types of equipment and want to have a third party provider. And so that means you don't get this consolidation towards OEMs as much, at least in the UK.

I think the third bucket that I think is also very important is that, I think it's just down to the lack of interest until quite recently because these days it's a very hot topic.

We get asked a lot about this about from investors. But if you wind back, say, five years in time, this was not really an industry that people were talking that much about, and it's flown a bit under the radar on the fact that it was very fragmented and has a lot of characteristics that investors like.

Now, more recently, that has really started to change, and that's why we started to see a few more essentially classic PE platforms emerge which indeed are starting to pursue much more M&A.

So I think we're now starting to move into a phase where consolidation is starting to happen, but it is from a starting point of great fragmentation.

Question: In terms of the market, so for the players in the UK, is it very easy to expand geographically – does regulation impact organic growth into foreign markets?
Answer:

I would say it's very different by country - I would think of these as very national markets rather than a European market. In general it comes down to the fact there's very few synergies from being present across multiple countries, at the service level that is obviously; for manufacturing we can come back to separately, but at the service level it's all about having engineers locally, the actual requirements are actually different by country and because of that there are very few real benefits of being present in another country beyond the fact that you unlock a bigger market. But then these markets are already quite big and fragmented in each individual country, so there's a big question: "what's therefore the benefit of going to another country if I have so much headroom in my current core market". And I think that's why we've actually seen the markets be very isolated at the service level. Now some of the very largest players obviously have more international footprint, but I'm not sure I would frame that as a big merit per se.

It's quite sub-national. If you look at the players of 5 million in revenue and below, they tend to be very geographically constrained down to even single cities, e.g. London or groups of cities, and then the typical expansion is you'll have to expand geographically within a location, a region, then into a country, but the latter is very rarely in fashion.

This would be different for manufacturing because the manufacturing space is much more a set of small brands. So a lot more consolidated and a lot more international, which is obviously just down to the dynamic of, well, manufacturing makes more sense at that level, and the products don't necessarily need that much tailoring to the market. It's really the fact that the service elements require tailoring because, well, you're doing it on site, and you need to meet specific rules in that country.

Question: In terms of revenue generation with customers. Is it contract-based, e.g. to run services at a recurring basis contractually, or is it rather transactional?
Answer:

The maintenance is very contract-based, and typically the contracts would be structured to a regular inspection, following often legally mandated inspection frequency, and contracts would also typically include minor remediation as well.

So if you notice that something is wrong you'll be the one that does the minor works to fix it.

That's the maintenance side. You then have the installation side. Which is more project-based by the nature of it. It's related to refurbishment or a new building, and so you'll often hire a specialist to come in as part of that project. But the maintenance is very long-term, quite sticky relationships, high level of recurrence between contracts, etc.

Question: How sticky are the customer relationships – is there a risk of customer churn and if yes what are the main reasons?
Answer:

It's very sticky. They do switch occasionally, there's always a risk of churn happening. But generally they're quite sticky, and often because for the customer: it's important that it's safe, because they can get to jail, if you're in the UK at least, if you are not complying with fire regulations — they care about compliance a lot.

But it's also a relatively small part of their overall budget — they want to have a good provider, but it's not something they spend a lot of time maximizing.

But I would briefly add to that as to say, it's not that there's hard barriers for switching, it's not it's actually generally difficult. I think it's much more about a risk aversion of what it entails, and practically what that means is that: the switching that we do see happen tends to be triggered by some form of failure, as in there's a big serious mistake in terms of either you have someone who weren't compliant on a site, and you found out a genuine issue was done, or there was a big service issue of the engineers just kept being really late and missing appointments. Churn would be associated with something that actually really went wrong in one way or another, and therefore someone switched.

Question: And when it comes to choosing providers – how do customers decide themselves for one provider – what are key differentiating factors they look at here? Answer:

Here there's also a question around what you look at during the procurement process versus what is customer value during the service implementation process. It's worth thinking about these slightly differently. At procurement, the main thing is compliance. You need to have someone who is compliant with all the right regulations, and has a track record of delivering compliance services. Then price always matters — It's rarely the most important factor, but it is always important.

Then, the most important factor during the service life is often turning up on time and delivering the compliance results, quickly and efficiently. It's often hard to test those at procurement, which is why they're a bit different. But it's actually having engineers that consistently turn up on time. This turns out to be quite a good differentiator in this market and allows it to drive really strong customer stickiness.

Question: What are the main profitability drivers?
Answer:

First of all, the margins vary hugely in this industry. One of the things in this industry which is interesting is how much variation there is, as in you'll find anything from 5% low-ish EBITDA all the way up to 30% EBITDA. So there's a huge range of performance across different providers, and some people are doing very well, and some people are not doing very well.

And the second interesting point would be, it's actually not just to do with scale. Actually, scale plays quite a small role in that. So it's not as simple as "the big providers are making good margins and the small providers are making low margins". Actually, the relationship between scale and profitability is quite weak. And scale only offers you a small amount of advantage — some advantage — but second order of effect advantage.

And in terms of then what actually drives those differences, to the heart of the question — it turns out typically to be a very complicated question and very business specific.

It's hard to single-out one specific reason that drives profitability. It could be a variety of factors: could be anything from, they charging a price premium. It could be about they're using either more of an indirect channel rather than a direct channel, indirect being facility management companies.

It could be about:
-Providers being very choiceful about their contracts they're picking in the market and only going for the high profitability ones or building scale in a specific area
-It could be about the end market mix in e.g. social housing, or it could be about service line mix as well, it can be about the use of subcontractors and the operating model they have
-Or it can be about the technologies that are employing

Whenever we see someone making a high margin, it tends to be for one or several of these reasons. However, there is not one factor that can be consistently named as responsible.

Question: At the cost level, what is the main cost providers have?
Answer:

Personnel costs are the highest.

Mostly because a lot of visual inspections require people to go into them. It is a lot of route engineer-based workforce utilisation.

For example: So how can you get people to site as quickly and efficiently as possible? This is why local density is quite important, but national density is not so important because you're driving engineers around.

National density mainly tends to have an impact in situations where you're selling to a client that actually has a big local footprint across the UK, and wants a single provider. But that's still a relatively small part of the market. And even some companies that actually are national would still procure locally by region.

So it's not always an advantage. But some of the bigger providers do try to focus a bit more on this segment, essentially, of national customers.

Question: Market outlook-wise: Can you make an estimate of the size of the fire inspection services market in Europe?
Answer:

If we look at the UK fire safety services market, that will then be around GBP 3 billion market, and that market will be growing at 4 to 5%.

One can expect that the growth rate is probably quite similar for the equipment market, because it'd be very odd if services had a very different trajectory to the underlying equipment manufacturing.

Question: What would be 3 market drivers that are sustaining growth in the industry?
Answer:

You have the volume of building stock, which is one main underlying volume metric driver.

And the one thing that's different between equipment and servicing is: equipment is much more exposed to the new building volume, because when you bring a new building and you buy a lot of equipment for it; whereas the servicing is exposed to the existing building stock, because it's related to frequent inspections on existing buildings, and refurbishments.

That's your underlying volume driver, and then you have the compliance rate. Generally, buildings are mostly 100% compliant, but there's always some gray area in individual building owners not being fully compliant. Particularly in the UK, you saw post-Grenfell disaster, you saw an uptick in compliance rate, where people were really bottomed down on making sure they met the national regulations, because they realised how bad it could be, and they're worried about legal consequences.

On that specific point, the reason why it's not entirely clear-cut on compliance is simply because the requirements are not always hyper-specific. It's not as in the regulation says one needs to necessarily check a specific component every X years. Compliance states this for some specific products, but not on all products. Hence, it's often up to the interpretation of the customer to assess what is a good compliance regiment of "how often things should be inspected and maintained". This is what creates still a degree of gray area. Therefore, if people are more worried about the risk, they will just tend to spend more to compensate for it as they want to make sure they go above and beyond.

This is the effect that has been seen post-Grenfell incident.

This effect has now largely played out, and it's now going to reach a more stable environment.

That leaves us in a position where regulation is really also driving the market here — beyond inflation and underlying building stock. It's a matter of when do bumps in regulation come in, and you'll see, especially in fire, there tends to have been multiple regulations over time that have come in at various points.

The one that's probably most prominent at the moment is the building safety case, and that's coming in the UK, which essentially means that all buildings need to have a plan for what happens in a fire. That's caused a relatively one-off push for services. That will drive an uptick in that segment of the market for a few years to come.

Question: What would be then 3 market challenges that can negatively affect growth?
Answer:

First of all, regulations probably are slowing down, as in, regulation has been a material driver in the past. It will continue to be a driver, but the upcoming regulation is not as strong of a pipeline, versus what has been in the past. So that doesn't mean the market is going to decline, but the pace is actually slowing down a bit. We mentioned the market growth is four to five percent forward, it probably was actually more than that in the past. This is the first effect, the market is a bit reliant on what the upcoming regulation will be. For example, the UK's building safety case, creates a one-off demand for a number of years, probably the next four to five years, but there's quite a lot of uncertainty about what will happen after that.

And then I think a relatively big topic that we haven't talked about so far is the fact that there's quite a big role about remediations after Grenfell in the UK, which was a big disaster - and that essentially caused a huge push to improve the passive systems in building.

And that essentially led to many buildings having to do remedial works to be fit for purpose and being compliant with what they should have done. That is an enormous backlog and the work has begun, but even though it's been many years since the accident, there is still a big pipeline that is going to happen for many, many years to come. However, the big topic is still what is the shape of that pipeline and is that a five-year effect or a 10-year effect or a 20-year effect? We would probably lean towards actually this is a longer-term effect and this remediation pipeline is just so big that in the end of the day it's going to be around for a material amount of time. But it's still something that's important to get your head around.

Finally, there's a long-term potential for technology in this market. We'd argue probably that the short-term risk is probably overplayed, because there's some people talking about it. Whilst there are Internet of Things-style monitoring of fire safety, a lot of regulations sort requires visual inspections. It's not going to be a sudden displacement, but you are seeing increases or some evidence of increases in people using technology within their monitoring of fire assets.

And that's still very early stages, and probably only a few some customers are interested, but that actually could raise those barriers to entry if customers prefer a more digitally-enabled solution, and eventually it could impact volumes in the market if there was a change in regulation to allow more virtual inspections, essentially. That's very long-term off, but it's definitely potential.

Question: What about AI – are there visible risks of it affecting this market?
Answer:

In short, we don't think AI is going to be very destructive here at all. In part because of the regulations, e.g. are you truly going to trust it?

I don’t think we’ve seen any indication at all of there being any genuine adoption here, or that that will happen anytime soon.