POURING ANOTHER CUP O' JOE: POINTS FOR SELLERS TO PONDER AS THE M&A CLIMATE IMPROVES

By Patrick Henry | *August 14, 2012*

NEW DIRECTION PARTNERS

Editor's note: each month, the partners at New Direction Partners (NDP) join their colleagues at the financial management firm MargolisBecker in a "Cup O Joe": a conference call with printers on a selected topic of interest. The call's namesake is MargolisBecker founding partner Joe Becker, whose brainchild the monthly teleforum is.

Recently, NDP's Peter Schaefer and Stuart W. Margolis of MargolisBecker reviewed strategic concerns for buyers and sellers of printing companies in a gradually improving climate for print industry mergers and acquisitions. An edited version of the discussion is presented here.

Lately, we have seen a real increase of interest both in tuck-in transactions and in the purchase of more profitable companies at EBITDA multiples. As people grow more confident about the economy, there's more optimism that the worst is behind us. Printers are starting to figure out how to be profitable at lower revenues. Transactions have become a little easier to finance. It's just more bullish.

We see a pent-up eagerness to make deals not just in buyers, but also in sellers—companies that, until recently, avoided selling because it wouldn't have been profitable to do so. This makes it all the more important for those venturing back into the M&A marketplace as sellers to be clear about why they should sell—and why buyers should want to acquire them.

LATER THAN YOU THINK?

The thought process should start with a review of the owner's objectives. You have to ask yourself, "Am I going to turn the company over to my children? Am I going to work until I am 80 years old? Or, do I want to sell at some point? If that is a possibility, is the money I expect to receive at closing enough to do what I want to do with the rest of my life?" These questions will have to be answered at some point—sometimes, sooner rather than later. We have worked with companies whose owners were 55 or younger and just decided it was time for them to sell.

Deciding when the time is right to sell a business is always a very personal matter. But, as an industry, we're not out of the woods yet, and there are many situations where the owner doesn't have the luxury of waiting until personal objectives are fulfilled. Unfortunately, "fire sales" still happen. We recently heard from a printer whose bank had just informed him that two of his presses were about to be repossessed. The owner—43 years old—found himself needing to sell his company quickly, and not because he wanted to.

In a well-planned M&A, timing is everything—or pretty close to it. If you are thinking of selling to a third party, you don't want to wait until you are ready to leave the company. This is something else that, unfortunately, we encounter all the time. Acting on the buy side for a client, we visited what we thought was a very attractive target. The owner, however, informed us that he wanted to sell the company without any day-to-day involvement afterwards.

That's usually a deal-killer. The prospective buyer of a company that has been successful doesn't want to hear that the owner responsible for its success will no longer be there. This means that sellers in situations like these should plan on remaining with the business for two to three years after the deal is closed.

HOW CLOSE TO THE VEST?

Confidentiality is another matter for sellers to handle with care. When the owner is ready to sell, should the news be shared with staff and the marketplace? Or, should it be withheld, especially from employees? The answer, in almost all

cases, is that the seller should keep it as quiet as possible. This is a common objective. What differs, we find, is the extent to which sellers will to go to keep it quiet.

In a large deal we closed recently, the client was comfortable with informing members of his top management team and bringing them into the process. Until due diligence made it necessary for the buyer to come on site, no one except the owner and the senior managers knew that a sale was in progress. In our experience, buyers are very respectful of confidentiality and will work hard to preserve it.

On the other hand, there can be such a thing as too much confidentiality. We had another client who didn't want his management team brought into the process. We can work with this kind of restriction up to a point, but the seller must understand that the buyer is going to want to meet the top management team down the road. Will they agree to meet only with the owner at first? Yes. But they might not want to go to a letter of intent, for example, until they've had an opportunity to interview the management team.

As for employees, since they generally don't have anything to contribute to the sale process, it's our belief that in 99% of cases, they shouldn't be told too far in advance. Since they can't influence the situation other than by being concerned about it, premature disclosure does no good for them or for the employer. That's why owners often feel that the best practice is to keep the deal quiet for as long as possible, and then, when the agreement is firm, to break the news to the workforce as a whole.

But, it's up to each owner to decide what will work best. Some want to be open. They realize that employees know something is going on and probably are imagining things to be much worse than they really are. Others want the news kept under wraps until the last possible moment.

Whatever and whenever you tell employees, you must be as honest as possible. You can't tell them one day that you are absolutely aren't selling, and then in walks the buyer the next day. In a deal we just closed, our client handled it perfectly. He kept it quiet as long as he felt he could, and then he told everyone. He also set aside time for anyone who had questions. He was completely honest, up front, and available, and that was a key to the success of the transaction.

At the other extreme, there's the story of the three companies that were being consolidated in a roll-up. One of the owners put into the Friday paychecks the announcement that the companies were selling—before the deal was finalized! There are ways to do things professionally, and ways in which they shouldn't be done. This, obviously, was not the way to do it.

A LINGERING CASE OF THE "HICCUPS"

A different kind of timing question is the one asked by sellers whose companies suffered a financial "hiccup" two to three years ago—as 99.9% of all printing companies did. Does the hiccup continue to impact value today? The truthful answer is that to a certain extent, it probably does. If a company had just one "off" year and every year since then has been great, then it shouldn't affect value or the EBITDA multiple in a deal being structured that way. The 1% of companies that passed through 2008 and 2009 without any sort of hiccup can command a slight premium over the rest.

However, we saw a real problem in a recent deal where the seller had three years of negative feedback. This was the first year that the company was back on track, and the owner was looking for a really high multiple.

That just doesn't work. The buyer's reaction was, "Look, you've got to show me more than six or 12 months of a turnaround." If you are coming off a string of poor years, buyers really do have to be convinced that the worst is behind you.