BENEFITS OF A TUCK-IN

By Peter Schaefer | *Partner, New Direction Partners*

NEW DIRECTION PARTNERS

For over twenty years, we have heard printers say, “The value of my business is in its customers”.

THIS STATEMENT HAS NEVER BEEN MORE CORRECT!

Today, great and exciting technology is available to all printers. In fact, today’s technology makes it increasingly difficult to differentiate themselves because much of today’s technology is fail-safe. It therefore follows that the value of many printers are within their customer base.

In recognition of this, today are we seeing many printers selling their book of business to a local competitor. This type of transaction is advantageous to both the buyer and seller. The seller is able to obtain value for its business in today’s difficult economic environment. The buyer gains efficiencies by leveraging cost savings through the elimination of redundant expenses. With both the *PIA* and *NAPL* calling for this economic downturn to adversely impact the printing industry until at least 2014 and beyond, this type of transaction presents an attractive alternative to “hunkering down” and trying to wait for the current situation to improve.

This type of transaction has become so popular and prevalent that it has its own identity – *Tuck-In*.

Tuck-Ins come in many forms but generally they have the following characteristics:

- The buyer pays a commission for sales that are transferred from the seller, usually over a three or four year period. The percent commission varies but generally is higher for higher margin sales.
- The buyer purchases, at fair market value, the equipment necessary to serve the new business and the seller is responsible for disposing the equipment not required.
- The buyer assumes the responsibility for collecting the receivables and transfers collections to the seller. Both the buyer and the seller benefit when the buyer assumes the responsibility for collections. The percent of accounts transferred and the percent of accounts collected increases when the buyer collects receivables.
- Employees who are essential to service transferred sales are hired by buyer – usually customer service and certain sales executives. That being said, it is also frequently the case that the seller has other vital employees that the buyer chooses to hire as well.
- The seller is responsible for paying down the remaining accounts payable and other debt obligations.

BENEFITS TO SELLERS

Tuck-Ins have become popular with sellers because they increase the proceeds to the seller, especially when compared to closing the door through a liquidation of the assets.

- Maximizes the value of the business by selling the most valuable asset: sales.
- Expands opportunities to existing customers by offering the buyer’s new equipment and capabilities.
- Provides cross-selling opportunities.
- Preserves customer relationships.
- Preserves employment for salespeople and key employees.
- Potential tax saving opportunities.
- Enables the seller to receive higher proceeds if the sales to the existing customers grow beyond current levels.

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The following demonstrates a typical financial benefit to executing a *Tuck-In* for a $10 million in sales printer.

	LIQUIDATION	TUCK-IN	BENEFIT
AR COLLECTION $1,700,000 (70%/95%)	$1,190,000	$1,615,000	$425,000
ROYALTIES (5% of Sales)			
Year 1 (95% Transferred)	$0	$475,000	$475,000
Year 2 (90% Transferred)	$0	$450,000	$450,000
Year 3 (90% Transferred)	$0	$450,000	$450,000
Subtotal	**$0**	**$1,375,000**	**$1,375,000**
SALE OF EQUIPMENT	$1,000,000	$1,000,000	$0
GROSS PROCEEDS	**$2,190,000**	**$3,990,000**	**$1,800,000**

The above chart demonstrates how a $10 million printer can sell on a tuck-in basis and generate gross proceeds of approximately $4.0 million. If that same printer were to sell by the traditional basis of a multiple of earnings, we believe there would be less proceeds at closing. Assuming an above average Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) margin of 10% (or $1 million), the gross proceeds would be significantly lower given the current multiples offered to general commercial printers that are ranging from 3.0 to 3.5 times EBITDA.

In addition the seller can realize benefits from saving the jobs for certain key employees and for providing a continuity of service for long-term and loyal customers.

BENEFITS TO BUYERS

Tuck-Ins are popular with buyers because they are virtually risk free and represent the most efficient path for sales growth. In fact, profitable sales growth is more easily achieved through a *Tuck-In* as compared to slugging out it the market.

- Expands customer base.
- Increases efficiencies by filling capacity.
- Provides for profitable growth.
- Virtually risk-free.

The chart on the following page demonstrates, from a financial point of view, why a tuck-in works for both the buyer and seller. It demonstrates how a profitable $25 million printer can purchase a somewhat struggling or underperforming $10 million printer and increase its pretax margin from 2.5% to 7.3%.

PRO-FORMA ACQUISITION RESULTS

	YOUR FIRM	% OF SALES	TARGET FIRM	% OF SALES	ADJUSTMENTS $	ADJUSTMENTS NOTES	PRO-FORMA RESULTS	% OF SALES
SALES	$25,000,000		$10,000,000		($2,500,000)	A	$32,500,000	
MATERIALS	$8,500,000		$4,500,000		($1,125,000)		$11,875,000	
VALUE ADDED	$16,500,000	66.0%	$5,500,000	55.0%	($1,375,000)		$20,625,000	63.5%
FIXED FACTORY	$7,500,000		$3,000,000		($2,500,000)	B	$8,000,000	
VARIABLE FACTORY	$2,500,000		$1,000,000		($500,000)	B	$3,000,000	
GROSS PROFIT	$6,500,000	26.0%	$1,500,000	15.0%	$1,625,000		$9,625,000	29.6%
FIXED SG&A	$3,500,000	14.0%	$1,000,000	10.0%	($750,000)	C	$3,750,000	11.5%
VARIABLE SG&A	$2,500,000	10.0%	$1,000,000	10.0%	($250,000)	C	$3,250,000	10.0%
OPERATING INCOME	$500,000	2.0%	($500,000)	-5.0%	$2,625,000		$2,625,000	8.1%
NON-OPERATING	$125,000		$0		($375,000)	D	($250,000)	
PRE-TAX INCOME	$625,000	2.5%	($500,000)	-5.0%	$2,250,000		$2,375,000	7.3%

Purchase Price 5% Royalty Rate for Three Years.

A) Assume only 75% of target sales are retained
B) Benefits of combining facilities
C) Benefits of combining SG&A functions
D) Assumes Royalty Rate of 5% on Transferred Sales.