

NEW DIRECTION

PARTNERS

The other day, my children and I read together at naptime about *Slippidy Seal* and learned that, during a bad blizzard, the Harp seals hunker down until the end of the storm. Makes good sense to me. Since then, I have attended two industry conferences that were attended by top national printing executives. Interestingly, I heard repeatedly from many of the attendees that they are just trying to wait out this recession until the economy improves. This is an instance, though, in which what is good for Slippidy Seal might not be good for the printer.

The good news is that both NAPL and the PIA are calling for the recession to end by the end of 2009. The disappointing news is that nobody is going to even notice for many months after that, as the recovery from this deep downturn is forecast to be painfully slow at first, and not feel much like recovery until well into 2010. Although a natural reaction may be to "hunker down" like Slippidy, I (and most industry professionals) would argue that this is actually the time to be aggressive and willing to adapt and embrace changes in the marketplace. It is virtually impossible to remain status quo during a recession and is ultimately an opportunity to make strong companies stronger or, unfortunately, weak companies much weaker.

My partners and I have been involved in the sale or purchase of more than 200 printing companies. In working with each of these organizations, we have observed several characteristics that, almost without exception, the most successful ones have shared in common. These are companies that we have affectionately termed "Super Profit" printers, as they have continuously (even in these tough times) outperformed the Profit Leaders by virtually any measure. Even though they too may be experiencing a hiccup of some sort in these turbulent times (reduced revenues, lower profitability, etc.), they have strong fundamentals in place and are well positioned to become even better in the near term.

The vital first step to becoming a Super Profit printer is to learn how to control costs. These businesses live by financial benchmarks and ratios, such as sales per employee and valued-added and gross margins, and have learned how to minimize working capital requirements. By adhering to financial discipline, the management will likely be led to make some painful, gut-wrenching cost-cutting moves. Although never easy to do, this is a necessary process to even survive in today's environment.

The seven characteristics that we have observed of the Super Profit printers are as follows:

- Value attitude;
- External vulnerabilities managed;
- Conquer the Job Shop Manufacturing process;
- “Profit” corporate culture;
- Focused, quality management;
- Superior sales and marketing functions; and
- Customer loyalty and pricing markups.

Value Attitude. The management of these superior businesses are focused on maximizing long-term value, not short-term earnings growth. Rather than draining the business of its earnings year after year, the owners embrace the concept of retaining earnings to preserve the opportunity for future growth. They understand how their actions impact the financial statements, and they are not afraid to downsize or implement difficult initiatives aimed to adapt to a rapidly changing market.

Management of these companies work diligently to obtain a target capital structure and rely on sound financial benchmarks such as Return on Investment (ROI) and Economic Value Added (EVA) before buying equipment. This doesn't mean that they are resistant to capital expenditures; rather, they have the discipline to wait until their anticipated returns warrant such investment.

Two examples come to mind. First, we have had a long time client that is a specialty printer with revenues approximately \$50 million. The business is very profitable, generating very attractive (but not obscene) earnings over the years. The owners have always plowed the earnings back into the company and, today, it boasts a balance sheet with approximately \$15 million in cash and absolutely no debt. There is little question that this business is well-poised to thrive even in this economy. Another example is a general commercial client who has always willingly invested back in his business and enjoys a very healthy balance sheet. For years, he wanted to purchase a digital press, but his ROI analysis was never acceptable to his standards. In late 2008, with the introduction of some of the new, lower cost digital presses, his ROI became

acceptable. So, even though we are in these troubled times and his top-line has suffered along with the rest of the country, he proceeded immediately with the purchase of the new press and is very well positioned to take advantage of his enhanced product offering.

External Vulnerabilities Managed. Super Profit printers are mindful about their external threats and opportunities, and how they affect business. These companies are acutely aware of the actions, investments, strengths and weaknesses of each of their competitors. In addition, they understand how national, regional and local economic factors impact not only their business but their customers' as well.

These forward thinking leaders keep abreast of banking conditions and trends, which is vital in today's market. Another long-time client of mine was recently informed by his bank that his loan was being called. My client had never been late or missed a payment; however, the bank was having covenant issues of its own and needed to quickly turn some of its investments into cash for liquidity reasons. Fortunately, my client has a great network of friends in his area and was close with two executives from other banks, both of whom jumped at the opportunity to get his business.

Job Shop Manufacturing. One of the reasons why it is so hard to make money in printing is because the industry adheres to the job shop manufacturing process – the toughest and most expensive of all manufacturing processes. Super Profit printers have figured out a way to conquer this process and, as a result, generate superior gross margins. These companies have managers in every department who have a fanaticism for engineering plant throughput as well as “engineered” maximization of equipment utilization. Although they tend to shy away from “bleeding edge” technology, they are very willing to embrace advanced prepress and pressroom technology that will enhance efficiencies and ultimately improve the bottom line.

I recently had a client that was owned by a very dynamic father-son duo. The son was an outstanding salesperson, and the father's bailiwick was in operations. The plant was all half-size and operated three identical presses that were entirely interchangeable. The father studied each and every job to figure out how it could be produced as efficiently as possible with the greatest return and, as a result, the business consistently generated gross margins exceeding 35%. You don't see that too often in a mid-sized general commercial printer!

Profit Corporate Culture. The top printers have cultures that challenge the status quo and reward best practices. The management is universally respected and considered by co-workers to be “one of us”. As a result, everyone in the shop, from key management to supervisors to direct labor all strive to perform the best they can and they’re not afraid to make suggestions on how to improve the production process. I had a client that implemented a formal bonus program that rewarded employees who made such suggestions with a significant percentage of the savings generated by the suggestion. Several other clients have engaged their workforces by sharing their financial results on a monthly basis.

Yet another client took this a step further. He arranged for a seminar for all of his employees and demonstrated the impact of certain expense categories on profit. He started with a bucket that contained 100 pennies, and then had employees guess how many pennies would come out to reflect the cost of paper, utilities, etc. By the end of the exercise, there were only a few pennies remaining. My client reported that this was an eye-opening lesson for many of his colleagues and that for months afterwards he would walk around the plant and see employees working together to try to minimize these expenses so there would be more pennies for everyone to enjoy.

Focused Management. One would hope that this is rather intuitive but, almost without exception, Super Profit printers have people-oriented, compelling leaders who genuinely love what they do and coming to work each day. I feel that I can get a sense very early on how great a company is just by walking through the plant and observing how the employees interact with the Chief Executive Officer. Remember that quality emanates from the top down. The Chief Executive Officer ought to be viewed as the Quality Leader, and if he or she is well respected by the employees, the quality will be embraced by everyone.

Sales and Marketing Efforts. Super Profit printers have superior sales and marketing efforts that are complementary, but not equal in stature. They have highly skilled and energetic sales professionals who are empowered yet managed. The leadership, which is multi-faceted, has hands-on daily sales activity. In addition, many of these businesses have a marketing professional on staff or a partnership with a marketing firm that focuses on demonstrating the business’ core capabilities and service offerings.

Customer Loyalty. By focusing on quality management, Super Profit printers, over time, are able to attract companies with similar values – thereby generating customer loyalty. Another way to earn loyalty is to make it as difficult as possible for the customer to take its business to a competitor. The best ways to accomplish this is by controlling as much of the data as possible or by developing a niche.

There is no question that this is a difficult environment in which printers can continue to build value in their organizations. With that said, this isn't the time to take a page out of Slippidy Seal's book and just hunker down. We need to be proactive in the steps we take to enhance profitability and, yes, even survive until the economy improves. When they days become brighter, you will be glad that you took these steps and your company will be positioned to reap the benefits of a strong harvest.



Peter is a Partner with New Direction Partners, the leading investment banking and valuation firm to the printing industry. Peter and his three partners have more than 100 years of experience in the printing industry and have been involved as either a principal or advisor in more than 200 M&A transactions.

Peter is an experienced dealmaker with twenty years of investment banking and valuation experience. He has personally handled more than one hundred transactions in virtually every segment of the industry, representing sellers as well as buyers. In addition, Peter has performed hundreds of printing valuations for ESOPs, estate and gift tax planning and strategic planning purposes.

Peter is a Candidate Member of the American Society of Appraisers and received a BS in Economics and Political Science from Trinity College and an MBA from Villanova University. He is a Member of NAPL's Soderstrom Society. Peter can be reached at (610) 647-6800, or pschaefer@newdirectionpartners.com.