STRATEGIZING THE ACQUISITION: A ROAD MAP FOR BUYERS

NEW DIRECTION PARTNERS

By Patrick Henry | *July 22, 2013*

The M&A experts at MargolisBecker and New Direction Partners (NDP) frequently join forces to help well-matched printing companies come together in mutually advantageous deals. And while they emphasize that no two acquisitions are identical, the experts say that the successful deals they've managed do offer lessons that other would-be buyers can learn and benefit from.

One of them, says NDP partner Peter Schaefer, is that "growth" for printing companies today very often means "growth by acquisition."

Organic growth in competitive or declining print markets is hard. Growth through acquisition, says Schaefer, offers printers another path to building revenue and profitability; increasing equipment utilization; entering new vertical markets; adding service offerings or new technologies; reducing dependence on key accounts by diversifying the client base; and keeping customers convinced that the company is healthy and in expansion mode.

MargolisBecker and NDP are often called upon to craft deals for acquisition-minded printers who, wisely, do not want to undertake the complex process of buying another company without first seeking expert help. Schaefer says that his initial piece of advice to these clients is simple: "The purchase price is not the first thing to focus on."

Buying a company is a multi-step process, says Schaefer, and it properly begins with developing objectives and a strategy for acquisition. Next comes identifying potential target companies that will satisfy those objectives.

The process continues with researching potential target companies and refining the contact list. Now the stage is set for negotiation, due diligence, and financing. As a control step, the buyer "circles back" to the initial objectives to ask whether everything supports them. If the answer is yes, that's the green light to complete the deal. If the answer is no, it's time to start the process again.

Schaefer notes that these steps apply both to traditional "cash at closing," EBITDA-based deals and to tuck-ins, where the seller is paid through an earnout. Different levels of due diligence are needed for each type.

Develop objectives and strategy. First, the buyer must identify targets. Databases, industry periodicals, and other kinds of market research will yield leads. Then the question Is how the targets should be approached. Schaefer says that buyers should strongly consider getting third-party assistance for these opening gambits.

Research, he points out, means making a heavy commitment of time to gain a thorough knowledge of the market. Few printers can afford to take the necessary hours and effort away from the daily operation of their businesses. Even after solid research, approaching a competitor with a purchase inquiry can be awkward—so awkward that the seller's first response to may be a flat no.

Schaefer points out that an independent third party can bring about a win-win situation for both parties by laying a neutral groundwork for future discussions. The adviser's experience with due diligence makes it easier for the parties to understand what is normal and reasonable in structuring the deal and in obtaining financing.

Research potential target companies. Now the task is to refine the initial list to a few select companies that best meet the buyer's strategic objectives. It begins with the simple question of whether the buyer can work with the seller. This means finding out what the seller really wants so that the buyer can determine whether both sets of objectives are complementary.

Financial stability is an obvious prerequisite. Schaefer says it can be revealing to ask whether the sellers could still get value from their company if the deal did not go through. Ongoing business loss, significant debt, personal guarantees, weak profitability, and the lack of a succession plan should all be regarded as red flags.

Other things to consider, says Schaefer, are the seller's management expertise; the likely compatibility of the seller's business culture and the buyer's; and the "stickiness" (loyalty) of the seller's customers.

Buyers who want to pinpoint their ideal candidates also must understand current market multiples and factors that impact them. The current market range for pricing, according to Schaefer, is 3.5 to 5 times EBITDA (earnings before interest, tax, depreciation, and amortization). He cautions, however, that variables will come into play in the calculation of the final selling price.

An asset-based transaction, for example, will not follow the same pricing model as a tuck-in. And while the size or critical mass of the target company is a factor in its valuation, the determination of that value depends on the market segment the company occupies.

Schaefer says that because general commercial printers and book printers are seen as struggling and in transition, their valuations tend to come in at the low end of the range regardless of their growth and profitability. On the other hand, companies specializing in large-format output, digital printing, and data analytics look better in buyers' eyes and thus will go to the upper end.

Negotiation, due diligence, and financing. At this stage, before due diligence begins, both parties sign a non-binding Letter of Intent. This document should include language permitting any preliminary agreement to be amended if due diligence reveals factors that impact the value of the selling company.

Being thorough in this phase is crucial to avoiding nasty surprises after closing, says Schaefer. He notes that the level of due diligence required depends on how the deal is being constructed.

In a tuck-in, where the only thing buyer intends to obtain is the seller's book of business, understanding the seller's customer relationships obviously is critical. Payment histories, job pricing practices, and the track records of salespeople all have to be taken into account.

A traditional asset-based sale entails acquiring the whole company, and this broadens the scope of due diligence accordingly. Now the buyer must be prepared to conduct in-depth reviews of assets and inabilities; consistency of earnings; intellectual property; contracts; financials; and, where it exists, company stock.

"Circle Back." A few simple questions at the end of the process will clarify whether the opportunity truly is worth pursuing, Schaefer says. He recommends that buyers ask themselves:

- Did you find a company that fits your strategy?
- Do you understand the personal issues and needs of the seller?
- Have you addressed those personal issues to the seller's satisfaction?
- Does the due diligence support the deal?

"Yes" to all of the above means closing the deal. Negative answers indicate setting it aside and moving to the next target. The process ends only when the papers are signed and both parties are feeling equally good about the merger they have just completed.