WHAT DRIVES VALUE IN TODAY'S MARKET?

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NEW DIRECTION PARTNERS

Simply — as we learned in Economics 101 and 102 — Supply and Demand!

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Over the last three years there has been a dearth of fully integrated digital solution providers for sale. There have been exceptions but clearly supply has been way below demand. Supply is increasing but today and for the foreseeable future we expect the market to remain a "SELLERS MARKET ".

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The demand side of the supply / demand equation is far more complex. Demand is being determined by the financial position of potential buyers and by the attributes of the sellers.

FINANCIAL POSITION OF BUYERS

Strategic buyers (i.e. firms already in related industries) and private equity firms represent the logical and most active buyers for integrated digital solution providers. Strategic buyers are stratified into those whose own value is low (below 5x EBITDA) and those whose value is high (above 5 EBITDA). The low value firms need to purchase fast growing integrated digital solution provider in order to reposition into faster growing markets. Sometimes these buyers, usually connected to the commercial print industry, can't afford to pay a full price for integrated digital solution providers. More frequently than not, low value buyers see their offers rejected for integrated digital solution providers.

VALUE CREATOR – Distance your firm from commercial printing.

The high value buyers are usually connected with fast growing markets such as packaging, grand format or are digital solution providers. These firms can afford to pay more for your firm.

Private equity firms are also active in the ownership of digital solution providers. They have significant money to invest. Private equity will seek investment returns north of 25% pa. Private equity relies on leverage and growing markets to achieve these superior returns.

VALUE CREATOR – Position your firm into faster growing markets.

ATTRIBUTES OF SELLERS

The strongest creator of value is growth – sales and profits. Certainly, historical growth in sales and profits is the best predictor of future growth. Such firms are rewarded with the highest values. The next most important creator of value is size - the larger the firm the higher the value multiplier. We see a significant increase in buyers for transactions with a value greater than $25 million. The sellers in these transactions normally enjoy a 1 times to 1.5 times EBITDA increase in value.

MOST INFLUENTIAL VALUE CREATORS:

1. Rate of growth of sales and profits including growth rate of underlying markets.
2. Size of firm

Beyond rate of growth and size, several seller attributes drive greater value.

Increasingly, successful digital solution providers employ technology that interfaces with clients and facilitates the design, ordering, production and fulfillment of jobs. Such technology is frequently self-developed and increases the "stickiness" between printer and client.

Most internally developed technology increases value. Proprietary technology drives sustainable differentiation. Participants in other segments of the printing industry have often seen their value destroyed because they only used technology available to all participants. They were unable to differentiate their service offering. The use of self-developed proprietary technology is the most significant mega trend impacting graphic communications. In fact, I believe propriety customer interface technology will change the dynamics of competition and result in a healthier and more prosperous industry.

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Customer concentration may decrease value but its impact can be mitigated by length of relationship, contractual relationship or by the structure of a transaction.

There are several destroyers of value. Roller coaster sales and profit performance indicate either inadequate management systems or inconsistent execution of marketing and sales strategies.

Poor production work flow dampens the ability to scale and many buyers will discount value for the cost to reconfigure workflow.

Concentration of customer relationships and reliance on a single key executive will increase the risk of business continuity. All firms regardless of their timing to seek liquidity should have a succession plan that reduces the risk of reliance on a single key executive.

In summary, sales growth, profit growth and size create value. Potential sales and future profits are kinetic. If an owner of a digital solution provider seeks liquidity in the near future, his or hers foremost mission should be in driving sales and profits.

Paul V. Reilly is a partner with New Direction Partners, a leading investment banking firm servicing exclusively the graphic communications industry. In the last year Mr. Reilly participated in over 20 transactions including digital solution provider and digital packaging engagements. He can be reached at 303-520-7803 or at preilly@newdirectionpartners.com.