The State of the M&A Marketplace: Recap and Forecast

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The wind that filled the sails of M&A activity in 2018 is still blowing, but the weather could change. Come what may, here's how owners can navigate to successful deals this year.

Although the stock market's December debacle might have left us all feeling a bit shaken, closing 2018 on that jittery note didn't change the fact that the year as a whole had been another good one for mergers and acquisitions in the printing industry. At New Direction Partners, we're still reasonably confident that 2019 can be favorable for buyers and sellers of printing companies. But, we're also counseling our clients about what to do in case it isn't.

What we saw in 2018 was a replay of the same trends that have shaped the M&A marketplace over the last two to three years. Printing and packaging continue to rank among the nation's most highly fragmented industries, and fragmented industries inevitably consolidate. That generates M&A activity among companies of all sizes and types.

We witnessed it as big strategic buyers like Mittera Group and Quad Graphics announced headline-making deals. Equally newsworthy in the packaging segment was Transcontinental's $1.32 billion acquisition of Coveris Americas, one of the top 10 flexible packaging converters in North America. WestRock kept up its buying spree by completing acquisitions of Plymouth Packaging Inc., KapStone Paper and Packaging Corp., and Schlüter Print Pharma Packaging in 2018.

And then there were the private equity (PE) buyers, flush with cash to invest and growing even friendlier toward commercial printers and packaging companies (especially the latter) in their quest for profitable plays. It's our impression that the PE investors, as financially motivated buyers, may have edged ahead of the strategic buyers in their enthusiasm for certain types of deals (although the strategic buyers haven't lost any of their commitment to growth by acquisition, which is generally easier for them to achieve today than organic growth).

We've seen PE investors offering higher multiples of EBITDA for companies they like than strategic acquirers are prepared to put on the table – an indication of how eager financial buyers have become to move their money off the sidelines and into the ownership of printing and packaging firms.

Which firms are garnering all of this attention? The ones we call the "haves": companies with business models that have more to offer potential buyers than the less progressive "have nots." Haves on the commercial side are in premium segments such as large-format output, retail POP, and 1:1 print communications. Flexible packaging, food and beverage labels, and pharmaceutical packaging are among the applications that buyers like to see packaging businesses engaged in.

The brightest stars are spectacular performers in the $25 million to $100 million range: companies that move quickly, invest in the latest technology, and do whatever it takes to keep their customers close. Very often, they're in the forefront of the industry trend that's come to be recognized as convergence: printers adding new capabilities that let them expand beyond their core businesses into new and highly profitable adjacent markets.

There are quantitative as well as qualitative reasons for the high multiples of EBITDA that these companies tend to attract. The quantitative measures include consistent revenue and earnings growth, critical mass in markets served, and a non-concentrated account structure. Qualitatively speaking, traits such as having identifiable, defensible specialties and a world-class management team come into play.

Buyers, particularly financial ones, will pay premiums to close deals for businesses with attributes like these. That's as true now as it was throughout 2018, and the other factors that made 2018 a propitious year for M&As stayed in place as we moved into 2019. However, there's a caveat, and it's not a small one: we aren't quite as bullish on the outlook for the print M&A marketplace this year as we were a few months ago.

The reason, of course, is uncertainty about the economy. The stock market underwent a correction in December, and while that in itself isn't a cause for alarm, it reminds us of the what-goes-up-must-come-down nature of the bigger picture. No economist would dispute that the next recession is out there on the horizon somewhere. A pessimist might claim that one is overdue, given the long duration of the recovery since the last recession in 2007-2009.

This is what makes us cautious: cautious enough, in fact, to advise owners who may have been thinking about selling within the next year or two to move forward now. If the economy nosedives and takes the industry with it, an owner might have to wait another three to four years to sell at current value (assuming that the company rebounds completely). That puts retirement plans on hold and threatens to diminish the financial reward that the owner has worked long and hard to secure.

For prospective sellers, the action to take is straightforward: prepare for acquisition by getting the house in order without further delay. Begin by engaging an accountant to review the 2018 financials. Then, anticipating the due diligence the buyer will perform, eliminate anything that might make the buyer nervous and thus reduce the value of an offer.

This means retiring as much debt as possible. Review the list of customer accounts, and make tough calls about the unprofitable ones. The buyer, remember, may be more interested in the quality of the sales the acquisition will bring than in anything else that comes with it.

Although we generally recommend against making major capital investments while in selling mode, this doesn't mean putting off spending on systems and equipment essential to keeping the company productive and profitable. A buyer who perceives a significant gap in the seller's capability may feel the need to dial back the offer by the amount that will have to be spent to fill the gap after closing. Avoid that by looking at the production department through a buyer's eyes and investing in what's critical to have there.

As painful as it may be, now also is the time to trim unnecessary staff, a move that will help to strengthen the balance sheet. If family members or other shareholders need to be brought on board with the idea of selling the business, the owner should get started on that bit of internal diplomacy.

A point we always emphasize is that selling a printing company takes time, from preparing the business for sale and connecting with potential buyers to undergoing due diligence and closing the transaction. The process can't be rushed, and months will elapse before the selling owner will at last be free to take his or her long-awaited walk on the beach.

We helped numerous clients to reach that happy conclusion last year, and we're looking forward to guiding more print business owners in that direction in 2019. The outlook for the M&A marketplace may not be as unclouded as we'd like, but it's still a good time to be a seller – for sellers who are prepared to act now.

New Direction Partners is an investment banking and financial advisory services formed by Peter Schaefer, Paul Reilly, Jim Russell and Tom Williams to serve the printing and related industries. Services include merger advisory services through the representation of selling shareholders as well as buy side representation, valuation services, financing and refinancing efforts, turnaround and restructuring services, and temporary/interim management consulting. To learn more about New Direction Partners, visit New Direction Partners' website at www.newdirectionpartners.com.