

# Re-Imagining M&A...

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## in Today's Unprecedented Times

Paul Reilly & Joe Polanco, New Direction Partners

In partnership with PIASC, WSPA

Moderated by: Cary Sherburne, Sherburne & Associates

May 21, 2020



# Agenda

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- Current Environment – Industry & Overall Economy
- M&A Trends and Pandemic Impact
- Premium Segments & Industries Served
- Valuations
- Key Factors For Success of Effective Acquirers
- Types of Transactions
  - Multiple of Earnings
  - Tuck-Ins

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**“Nobody in America’s ever seen anything else like this... Everybody talks as if they know what’s going to happen, and nobody knows what’s going to happen.”**

**CHARLIE MUNGER, VICE CHAIRMAN BERKSHIRE HATHAWAY**

# Current Environment – Industry All Over the Lot

- “Our revenue is down by 30%.” **MAILING HOUSE**
- “Our sales volume is down by approximately 35%.” **WEB & SHEETFED PRINTER**
- “Our transactional offset print has decreased by 50%, but our personalized digital work is holding its own.” **GENERAL COMMERCIAL PRINTER**
- “Entered sales are down by about 50%.” **BOOKS**
- “Our sales are off by more than 50%.” **INSERTS PRINTER**
- “Our tradeshow and event business disappeared overnight. We are, however, surviving by producing PPE items”. **POP ENTITY**
- “Our revenues have increased by 45%.” **FLEXIBLE PACKAGING & LABELS**
- “We’re up by 30%.” **PHARMACEUTICAL PACKAGING**
- “Our revenues haven’t declined at all.” **STATEMENTS**
- “We had been doing great but, with everything at a standstill, some customers are holding back their mailing campaigns.” **1:1 DIRECT MARKETING**
- “We remained profitable in April and May will be in the black...but I’m worried about June and July. That said, our estimates have been picking up dramatically, so we be okay in the summer.” **RETAIL POP**
- “I’m busier than I have ever been since we opened in 2009.” **LABELS & PACKAGING**

**Average Change from Mid-March through Mid-April: -57.0%**

**SOURCE: SGIA INDUSTRY-WIDE SURVEY**

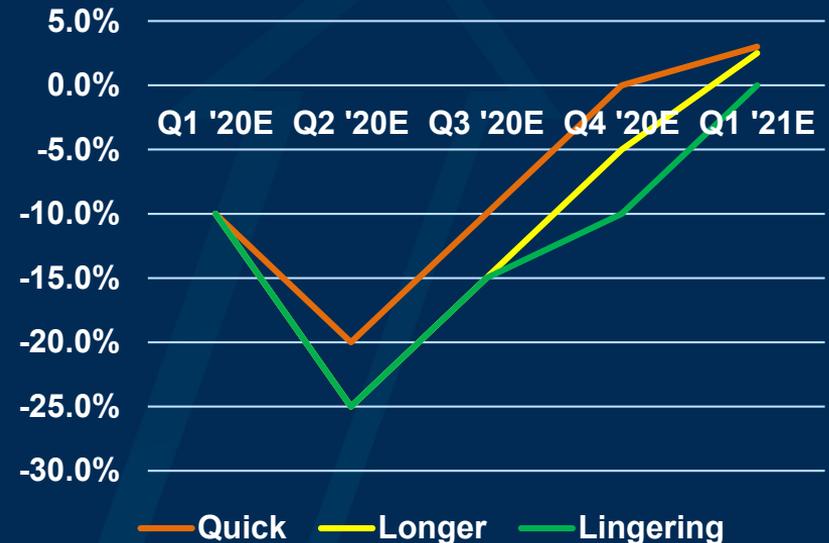
# The Industry – Recovery Potentially Begins in Q3, 2019

## Print Sales Change: Next 12 Months



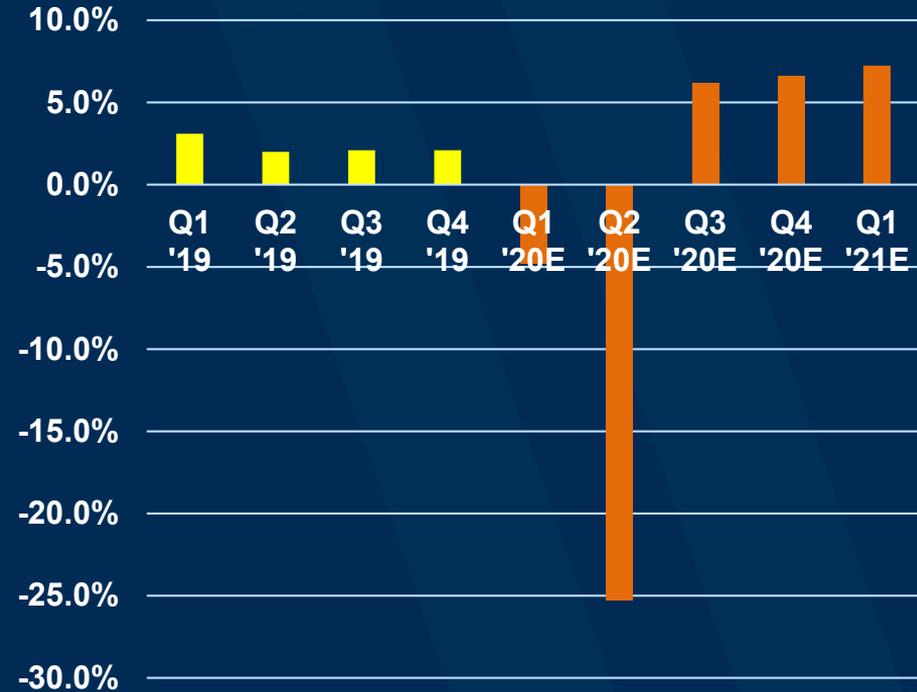
Source: PIA Flash Report

## Print Sales Pattern: Q1 '20 – Q1 '21



# The Economy – Recovery Starts in Q3 and Strengthens in 2021

## Quarterly GDP Change



## Annual GDP Change



Source: The Wall Street Journal (reprinted from SGIA)

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# Takeaways

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- The U.S. has the strongest, most viable economy in the world. We will recover and thrive once again.
- A recent survey confirmed that most owners are short-term worried and long-term optimistic.
- Print will also recover, but it will take time, and it is a likely reality that many printers won't survive the historic drop in revenue.
- Economists anticipate the recovery to begin next quarter (Q3, 2020) and strengthen in 2021.
- That said, with an anticipated decline in GDP of -4.9% in 2020, economists believe that this year will show the biggest GDP decline since 1946.
- Economists also expect that 2021 will be a year of great growth – fastest growth in 36 years and much more than our average of 2.5%.
- Some still predict a V-shaped recovery, most however are calling for more U-shaped where we'll bounce around at the bottom a bit before the uptick.
- Most anticipate that inflation will remain low until at least 2022; however, interest rates will likely increase beginning in 2021.

# Overview of the M&A Market (Pre-Pandemic)

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- In 2019 into early 2020, it was a great time to be a seller. Multiples were attractive for several reasons:
  - Strong economy, improved industry
  - Financial institutions lending at low interest rates
  - Financial buyers like printing again...(and they never disliked packaging)
  - Healthy public multiples
- It was also a good time to be a buyer. When correctly implemented, acquisitions:
  - Create value for customers
  - Create value for shareholders

# Overview of the M&A Market (During Pandemic)

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- Printers are naturally focusing on their business and doing what needs to be done to protect and care for their employees and their businesses.
- In these uncharted waters, deal closings will likely be paused but not cancelled. We fully expect that this is temporary only as corporate, strategic and financial buyers are putting things on hold to see what the recovery looks like and assess changes in the lending environment.
- Transactions for printers not negatively impacted by Covid are moving ahead.
- It is difficult to determine valuations given that nobody knows what the other side looks like yet.
- Many sellers are choosing to put their processes on hold until normalcy returns. In some situations, the buyers have been anxious to keep the process moving, which is an encouraging sign.
- Most companies in our industry are struggling during this time. This has already led to an uptick in tuck-in or cashless merger opportunities. When done correctly, this will create value for the buyer and seller, even if the seller is struggling financially.

# Overview of the M&A Market (Post-Pandemic)

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- When this is over and a favorable economic climate returns, we expect to see a return to strong M&A trends in our industry. The printing and packaging industries continue to rank among the most highly fragmented industries in the United States. Fragmented industries inevitably consolidate.
- Achieving growth through acquisition has proven to often be easier than organic growth or recreating technologies / workflows or market niches.
- Strategic buyers have excess capacity to fill...and PE buyers have a lot of money to spend!
- Valuable businesses exist that need liquidity, and owners are still aging...or lack the will to slog through another recovery.
- Certain segments remain highly price competitive and are experiencing profound shifts as a result of global market forces, labor trends, environmental regulations, the growth of digital technology, and the prevalence of electronic/social media. Time to reinvest or sell?
- Both industries are becoming “have” and “have not” industries. All buyers are striving to become more “sticky” to customers through technology, specialization and proprietary IT.

# How will the Pandemic Impact Valuations?

| Buyer Concerns           | Ways to Mitigate Concerns                                                                                                                                                                                                       |
|--------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Embedded Risks           | <ul style="list-style-type: none"><li>• COVID-19 had little to no impact on Seller's revenues</li><li>• Seller has a quick recovery</li><li>• Seller has demonstrated ability to right size and maximize efficiencies</li></ul> |
| Future Confidence        | <ul style="list-style-type: none"><li>• COVID-19 had little to no impact on Seller's revenues</li><li>• Seller has a quick recovery</li><li>• Seller has demonstrated ability to right size and maximize efficiencies</li></ul> |
| Solvency & Cash Reserves | <ul style="list-style-type: none"><li>• COVID-19 had little to no impact on profitability</li><li>• Seller has a quick recovery</li></ul>                                                                                       |
| Credit Constraints       | <ul style="list-style-type: none"><li>• Banks start lending</li><li>• Interest rates remain low</li></ul>                                                                                                                       |

# How will the Pandemic Impact Valuations?

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- The pandemic is a result of natural causes, not changes to the economy. As a result, many feel that buyers shouldn't penalize sellers.
- That said, because of perceived risks, buyers likely won't proceed unless they are confident that the seller has demonstrated a return to normalcy.
- If a seller quickly recovers, one way is for the buyer to remove the 2 -3 months of poor results and substitute in the same three months from last year – EBITDAC (Earnings Before Depreciation, Amortization and Coronavirus)!

# Winning in the M&A Playing Field

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## Typical Phases

- 1 -First wave of consolidation: - Mistakes are often made - Business models are not yet perfected - Initial market resistance to consolidation
- 2 -Second wave of consolidation: - Learn from mistakes of first wave - More thoughtful business models - Acquisition activity accelerates with educated market more ready, willing, and able to sell their business and join the consolidation effort
- 3 -Industry goes through complete transformation: - Changes in capitalization - Changes in competitive dynamics - Changes in market share mix

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Printing is between phases 2 and 3

# Industries Always Consolidate:

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## Four Typical Drivers of M&A

- Size, earnings lift, and multiple expansion
- Disruption of technology
- Disruption of the value chain
- Inability for smaller companies to respond

## Printing and Packaging Drivers

- Size matters >\$3 mil EBITDA, >\$10 million EBITDA
- Next big wave – It already started in commercial printing
- Initial purchasing economics have dissipated
- We are different; large firms struggle and very small firms struggle

# Successful Acquisition Strategies

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Successful Acquirers Have Been Implementing Solutions to Three Strategic Imperatives Confronting Printers:

- Replace sales from shrinking markets
- Drive efficiencies to mitigate lower pricing
- Reposition into growing markets.
  - New markets
  - New products / services
  - Technologies
  - European firms expanding to North America

# Types of Transactions

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- Traditional Earnings-Based Acquisitions
- Asset-Based Transactions (Tuck-Ins & Cashless Mergers)

# Earnings Based - How is value determined?

## EBITDA(C) Earnings Before Interest, Taxes, Depreciation, Amortization & Coronavirus Impact

|                                |                     |
|--------------------------------|---------------------|
| Adjusted Pretax Income         | \$ 800,000          |
| <b>Add: Interest Expense</b>   | \$ 200,000          |
| <b>Add: Depreciation</b>       | \$ 1,000,000        |
| <b>Add: Coronavirus Impact</b> | <b>???</b>          |
| <b>Adjusted EBITDA</b>         | <b>\$ 2,000,000</b> |

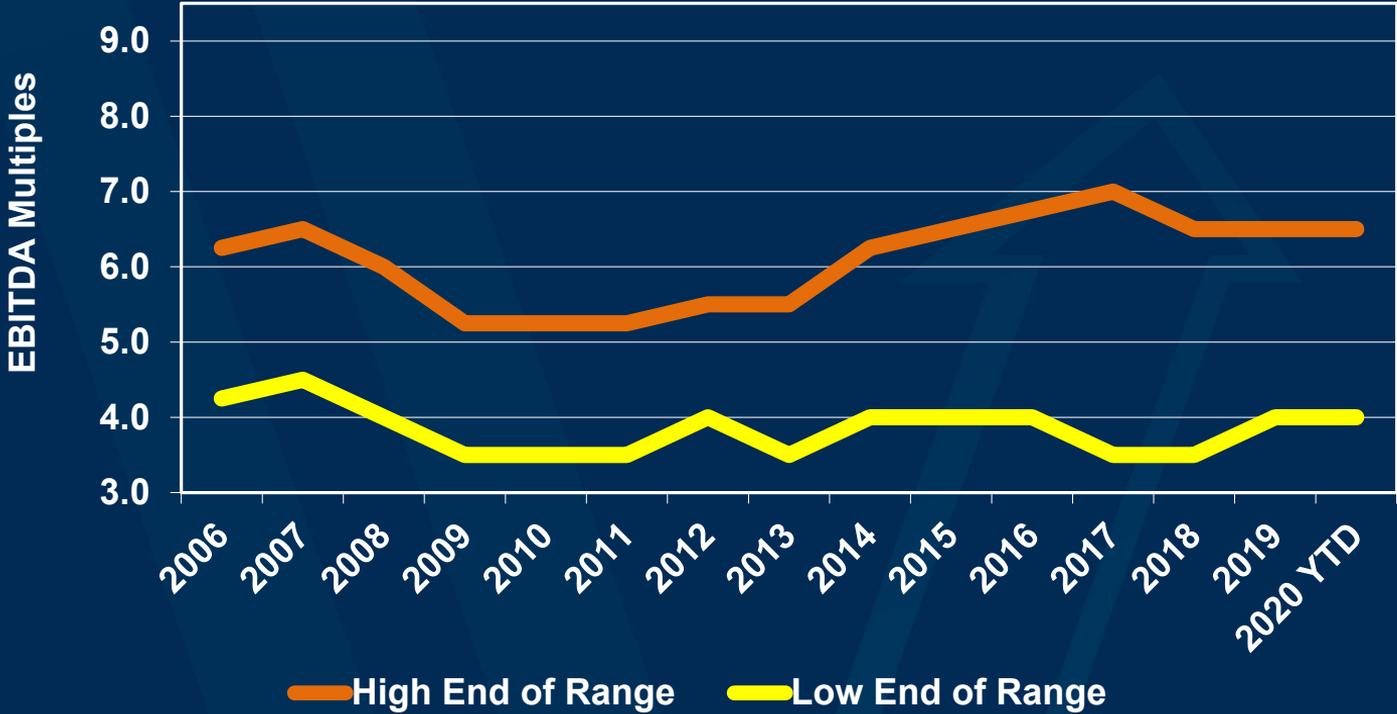
# How do we maximize value?

|                   |             |                     |                     |
|-------------------|-------------|---------------------|---------------------|
| EBITDA            | \$2,000,000 | <b>\$2,000,000</b>  | <b>\$2,000,000</b>  |
| EBITDA Multiple   | 4.0         | <b>5.0</b>          | <b>6.0</b>          |
| <i>% Increase</i> |             | <b>25%</b>          | <b>20%</b>          |
| Enterprise Value  | \$8,000,000 | <b>\$10,000,000</b> | <b>\$12,000,000</b> |
| Less: Net Debt    | \$3,000,000 | <b>\$3,000,000</b>  | <b>\$3,000,000</b>  |
| Equity Value      | \$5,000,000 | <b>\$7,000,000</b>  | <b>\$9,000,000</b>  |
| <i>% Increase</i> |             | <b>40%</b>          | <b>29%</b>          |

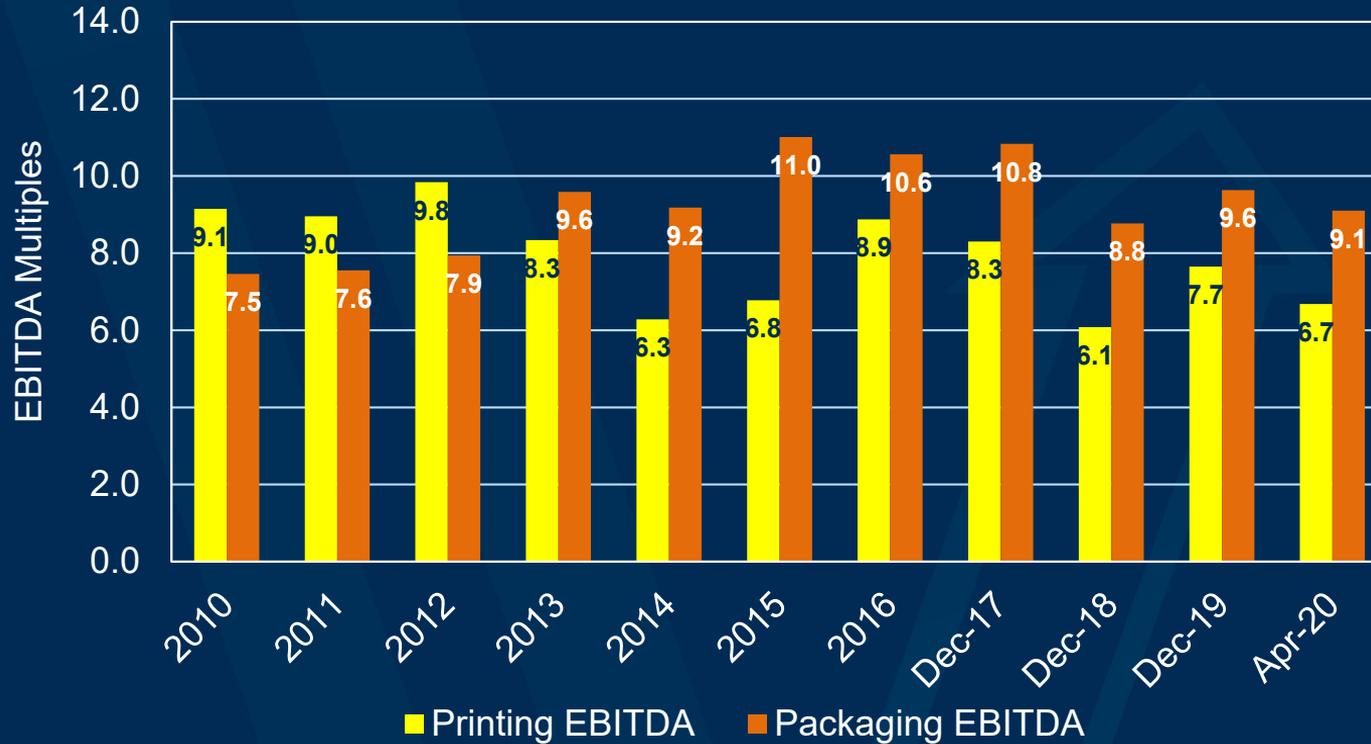


**The power of the multiple!**

# Historical Multiples Being Paid (Private)



# The NDP Printing & Packaging EBITDA Trend (Public)



# The NDP Printing & Packaging Stock Price Index (Public)



# What warrants higher multiples?

| Quantitative                                                   | Qualitative                               |
|----------------------------------------------------------------|-------------------------------------------|
| Trend demonstrating revenue growth/stability through Pandemic. | Identifiable, defensible specialties.     |
| Earnings growth/stability through Pandemic.                    | Growing customer loyalty.                 |
| EBITDA margins of 12% or more.                                 | Non-union workforce.                      |
| No account concentration above 20%.                            | Energetic and capable management.         |
| Critical mass within your segment.                             | Seller willing to stay.                   |
| Healthy balance sheet.                                         | No significant capital expenditure needs. |
| Non-lifestyle business.                                        | Technology - have, or have-not?           |

# Premium Segments

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## Printing

- Large Format / POP
- Program vs. Transactional
- Web-to-Print
- Customized 1:1 Direct Marketing
- Statements
- Digital
- Data Analytics/Creative/Cross Media
- Fulfillment
- Brand/Document Management

## Packaging

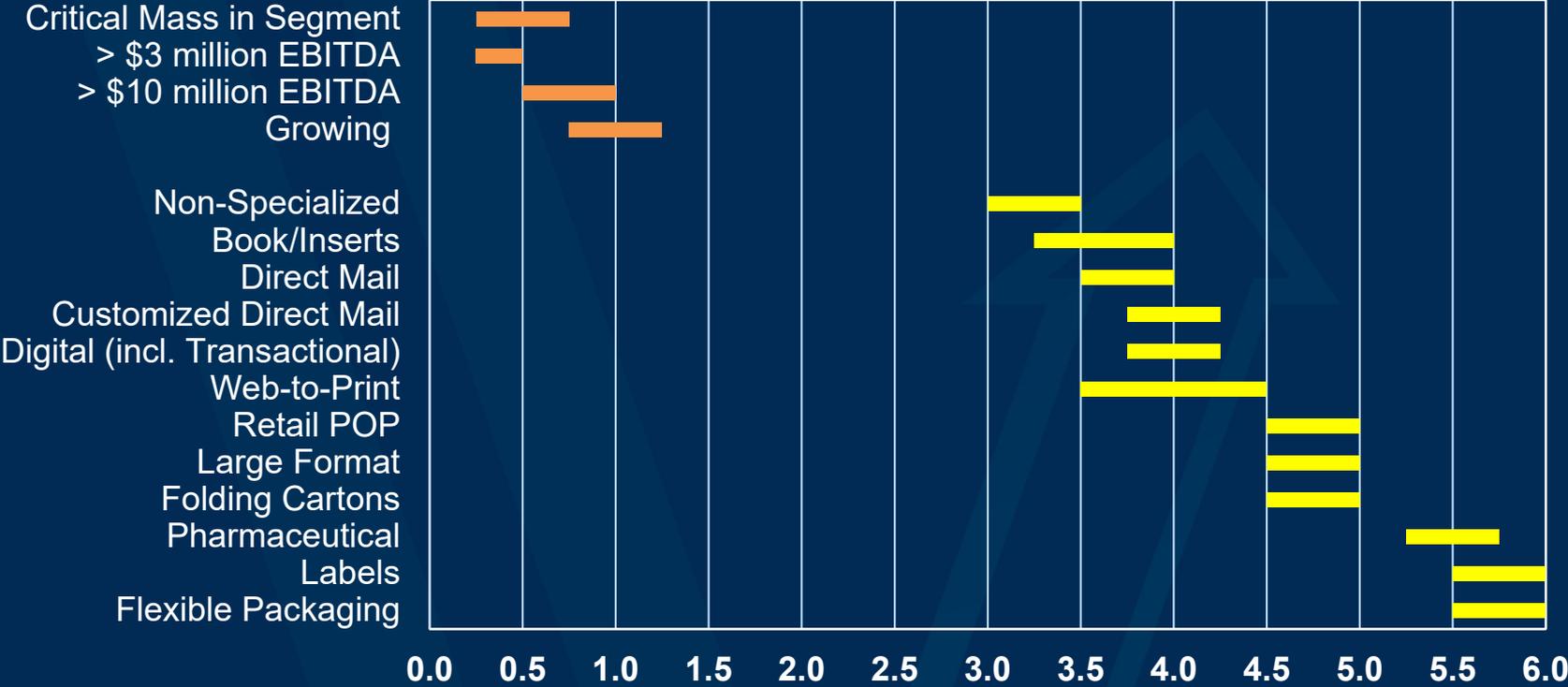
- Flexible Packaging
- Food & Beverage Labels
- Cosmetic Labels
- Pharmaceutical Packaging
- Folding Cartons
- Corrugated

# Premium Industries Served

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- Healthcare / Pharmaceuticals
- Government
- Food
- Games & Home Entertainment
- Home Fitness
- Children's Entertainment

# EBITDA Value Ranges



# Asset Market Valuations – Tuck-In and/or Cashless Merger

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## Three Elements

1. Net Working Capital at book value – realization usually warranted; plus
2. Production Equipment at OLV or FLV – either purchased by buyer or realized post closing by seller; plus
3. Royalty commission on retained sales for 2 to 5 years (Avg. 3 years) at 3% to 7%.
  - Actual terms are what seller can negotiate, and commission rate is normally a function of VA and variable operating expenses.

If 1 plus 2 doesn't satisfy funded debt, then 3 (commissions) may be prepaid at closing.

# Benefits/Risks - SELLER

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## Seller Benefits

- The royalty rate makes it more attractive than an outright liquidation.
- Sell what has most value – sales.
- Compensation received even with operating losses.
- Sellers can get higher price when sales return to normal levels.

## Seller Risks

- Paid over time.
- Buyer's ability to stay in business.

# Benefits/Risks - BUYER

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## Buyer Benefits

- Only pays for value received – sales retained.
- Little cash required!
- Only purchases equipment needed.
- Compelling economics by filling excess capacity.

## Buyer Risks

- Implementation resources.
- Fewer happening today.

# Consolidation Benefits

|                  | YOUR FIRM          | % OF SALES | TARGET FIRM      | % OF SALES | ADJUSTMENTS \$ | NOTES | PRO-FORMA RESULTS  | % OF SALES |
|------------------|--------------------|------------|------------------|------------|----------------|-------|--------------------|------------|
| SALES            | \$5,000,000        |            | \$2,000,000      |            | (\$500,000)    | A     | \$6,500,000        |            |
| MATERIALS        | <u>\$1,700,000</u> |            | <u>\$900,000</u> |            | (\$225,000)    |       | <u>\$2,375,000</u> |            |
| VALUE ADDED      | \$3,300,000        | 66.0%      | \$1,100,000      | 55.0%      | (\$275,000)    |       | \$4,125,000        | 63.5%      |
| FIXED FACTORY    | \$1,500,000        |            | \$600,000        |            | (\$500,000)    | B     | \$1,600,000        |            |
| VARIABLE FACTORY | <u>\$500,000</u>   |            | <u>\$200,000</u> |            | (\$100,000)    | B     | <u>\$600,000</u>   |            |
| GROSS PROFIT     | \$1,300,000        | 26.0%      | \$300,000        | 15.0%      | \$325,000      |       | \$1,925,000        | 29.6%      |
| FIXED SG&A       | \$700,000          |            | \$200,000        | 10.0%      | (\$150,000)    | C     | \$750,000          |            |
| VARIABLE SG&A    | <u>\$500,000</u>   |            | <u>\$200,000</u> | 10.0%      | (\$50,000)     | C     | <u>\$650,000</u>   |            |
| OPERATING INCOME | \$100,000          | 2.0%       | (\$100,000)      | -5.0%      | \$525,000      |       | \$525,000          | 8.1%       |
| NON-OPERATING    | <u>\$25,000</u>    |            | <u>\$0</u>       |            | (\$75,000)     | D     | (\$50,000)         |            |
| PRE-TAX INCOME   | \$125,000          | 2.5%       | (\$100,000)      | -5.0%      | \$450,000      |       | \$475,000          | 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.

# Questions?



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## PAUL V. REILLY

Mr. Reilly formed New Direction Partners in April 2009, an investment banking and financial advisory services, with Peter Schaefer, 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. Mr. Reilly frequently speaks at industry conferences on such topics as: Growing Market Share, Solution Selling, Mega Industry Trends, Competing with Consolidators and Merger & Acquisition Trends.

Previously, Mr. Reilly was Chief Executive Officer, President and Chairman of the Board of Cenvéo, Inc. (NYSE:CVO), one of North America's leading printing firms. During his ten years at Cenvéo, the firm grew from \$17 million to almost \$2 billion in sales with more than 10,000 employees, 86 plants and numerous sales offices throughout North America. While he was at Cenvéo, the company grew rapidly through acquisitions, completing some 60 acquisitions and numerous capital raisings, and created over 17% CAGR in shareholder returns. As CEO, Mr. Reilly led the transition of Cenvéo from a collection of independent firms to an integrated graphic communication firm providing its clients with multi-media solutions. Under his leadership, Cenvéo was voted second place in the printing and publishing category as Fortune Magazine's Most Admired Companies of 2004 and ranked number ten of the Russell 3000 companies on Corporate Governance Quotients by Institutional Shareholder Services.

He currently serves on the Meeting and Content Committee of the EMA. He is also a past member of The Business Roundtable, an association of CEOs from leading corporations who advocate public policies that foster economic growth, a dynamic global economy, and a well-trained and productive U.S. workforce essential for our future competitiveness.

Mr. Reilly has an undergraduate degree in Finance and an MBA in Computer Methodology from Baruch College. Previously a CPA, he served as a Bernard M. Baruch Graduate Assistant from 1974 to 1975. Born and raised in Queens, New York, Paul now resides in Colorado and Florida with his wife of 42 years, Patty. They have three grown children and six grandchildren. His interests include skiing, mountain climbing, mountain biking, sailing and golfing.



## JOE POLANCO

Joe Polanco is a long-time veteran of the Printing Industry who brings insights into trends and business practices honed over 40 years of print and association management. Polanco joined New Direction Partners in the Spring of 2016 after spending 20 years as the president of the Printing & Imaging Association of MidAmerica. The organization served the commercial printing community in Texas, Oklahoma, Kansas and Missouri. His involvement with the print community included working on several industry committees, which included developing Best Business Practices (Trade Customs); representing the industry regarding sales tax regulations (Streamline Sales Tax); as well as chairing the Dallas Small Business Committee for the Texas Commission on Environmental Quality.

As part of the Printing Industries of America's (PIA) affiliate team, he served on numerous task forces, as well as serving on PIA's executive committee and the board of directors for the Graphic Arts Technical Foundation.

Prior to joining the Printing & Imaging Association of MidAmerica, Joe spent nearly 15 years in various management roles with commercial, financial, and typography firms in the industry. He has been a frequent speaker at various industry events on topics ranging from pricing to taxes to the environment. He is a contributing author to Phil Ruggles "Printing Estimating," the industry's seminal textbook on print estimating and has authored a variety of articles for industry publications.

Polanco is a graduate of Cal Poly, San Luis Obispo's Graphic Communications program and holds a MBA from California State University, Long Beach. Born and raised in Los Angeles, California, he spent a short stint in Texas (40 years). He and his wife Liz, now reside in San Bernardino, California. Their children and grand children also reside in Southern California. Along with being an avid reader of all things print, Joe is an accomplished martial artist, with additional interests in biking, golf, and travelling. Not necessarily in that order.

