A 3-Pronged Route to Post-Pandemic Business Recovery

Paul Reilly & Tom Williams, New Direction Partners
Moderated by: Mark Michelson, Editor in Chief, Printing Impressions
NAPCO Media Educational Webinar
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Agenda

- Current Environment – Industry & Overall Economy
- Manage PPP Forgiveness
- Prepare for PPP Second Phase
- Augment Sales via 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

COVID –

“Not Business as Usual!”

NAPCO Research / Printing United COVID Survey – Key Findings

- Sales continue to decline and are far below year-ago levels, but the rate of decline has moderated among all companies surveyed and in all five printing segments studied.
- More companies report sales, production, quote activity, and work-on-hand are trending higher compared to the deepest days of the COVID-19 crisis.
- A fragile optimism has developed: 48.0% of companies surveyed expect business to improve during the month ahead, up from 16.2% in mid-April. There is concern, however, that the upturn will not be sustained through year end.
- More companies are holding employment steady (59.6%, up from 40.7%) and fewer are reducing employment (33.7%, down from 57.7%) compared to early spring. Federal loans are the primary reason: 71.5% have received assistance through the Paycheck Protection Program and 30.7% through another federal program.

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NAPCO Research / Printing United COVID Survey – Key Findings

- Those who applied for PPP loans indicated that their employment was remaining consistent at a much higher rate than those who did not apply (63.1% compared to 48.6%).
- States that began their opening process earlier indicated that their sales, production, profitability, work on hand, quote activity, and production payroll were trending at a higher rate than those that lagged in the process. Early states' index of current and leading indicators were 36.7 and 38.7 respectively while lagging states were 34.0 and 31.9. (Panel Edition)
- Eighty percent (80.0%) of firms were maintaining lines of communication with their clients regardless of their operating situation. Most elected to continue their traditional methods of outreach (79.0% used email), while some used this as a time to try new techniques such as web based virtual teleconferencing. (Panel Edition)

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Are you a “COVID Winner” or “COVID Wounded”?

- COVID Winners – Sales up or sales down less than 10%
  - Packaging
  - Labels
  - Commercial Niche – bankruptcy processing / signs
- COVID Wounded – Sales down more than 10%
  - Commercial
  - Serving Retail
  - Serving Events
  - Serving Travel/Hospitality
  - Serving Associations

All of the winners we talked to are not bullish about 2021!

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"Not Business as Usual" – Survival is Critical

NDP Recommendation – Hoard Cash!

- Manage PPP Forgiveness
- Prepare for PPP Part 2

NDP Recommendation – Seek "Tuck-in" Acquisitions

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Hoard Cash – Manage PPP Forgiveness

It's Not Too Late for most firms electing 24-week forgiveness period:

Size of PPP loans was based on about ten weeks of payroll period

Match your payroll period to COVID sales levels

PPP funds will last longer and most laid off employees will receive unemployment close to recent earnings.

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Manage Payroll – Use Value Added / Payroll $ Metric

Payroll costs as a function of value-added predicted profitability more reliably than:

- Sales
- Sales per employee
- Investment in technology / to sales
- Marketing / to sales

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METRICS INDISPENSABLE IN TODAY'S MARKET

VALUE ADDED per PAYROLL $

Sales less:

Materials,

Supplies &

Outside Services

/

All Payroll including:

Commission &

Temp Labor &

Payroll Taxes &

Fringe Benefits

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VALUE ADDED per PAYROLL $

		2019 Actual	COVID Level
Value Added -	Sales	$12,000,000	$7,800,000
	Less: Material Costs	$3,600,000	$2,630,000
	Less: Outside Purchases	$650,000	$150,000
Value Added		**$7,750,000**	**$5,020,000**
Payroll Costs –	Direct Labor	$1,950,000	
	Plus: Indirect Labor	$750,000	
	Plus: Temp Labor	$180,000	**TARGET**
	Plus: G&A Labor	$455,000	
	Plus: Sales Commissions	$740,000	
	Plus: Payroll Taxes and Employee Benefits	$775,000	
Payroll Costs		**$4,850,000**	**$3,137,000**
Value Added Per Payroll Dollar		**$1.60**	**$1.60**

Can You Exist After PPP Funds Run Out

- For Most, even those who elected the 24-week forgiveness period, PPP funds will run out by end of October.
- Several bills are in Congress to extend PPP
- A bi-partisan bill in the US Senate would extend PPP and offer forgiveness as a function of sales decline – not FTE changes.
- Lobby your US Senator and local House Representative to renew PPP!

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

- 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

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Overview of the M&A Market (During Pandemic)

- 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.
- 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.

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

- 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.

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How will the Pandemic Impact Valuations?

Buyer Concerns	Ways to Mitigate Concerns
Embedded Risks	• COVID-19 had little to no impact on Seller's revenues • Seller has a quick recovery • Seller has demonstrated ability to right size and maximize efficiencies
Future Confidence	• COVID-19 had little to no impact on Seller's revenues • Seller has a quick recovery • Seller has demonstrated ability to right size and maximize efficiencies
Solvency & Cash Reserves	• COVID-19 had little to no impact on profitability • Seller has a quick recovery
Credit Constraints	• Banks start lending • Interest rates remain low

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How will the Pandemic Impact Valuations?

- 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)!

Types of Transactions

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

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Earnings Based - How is value determined?

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

Adjusted Pretax Income	$	800,000
Add: Interest Expense	$	200,000
Add: Depreciation	$	1,000,000
Add: Coronavirus Impact		**???**
Adjusted EBITDA	**$**	**2,000,000**

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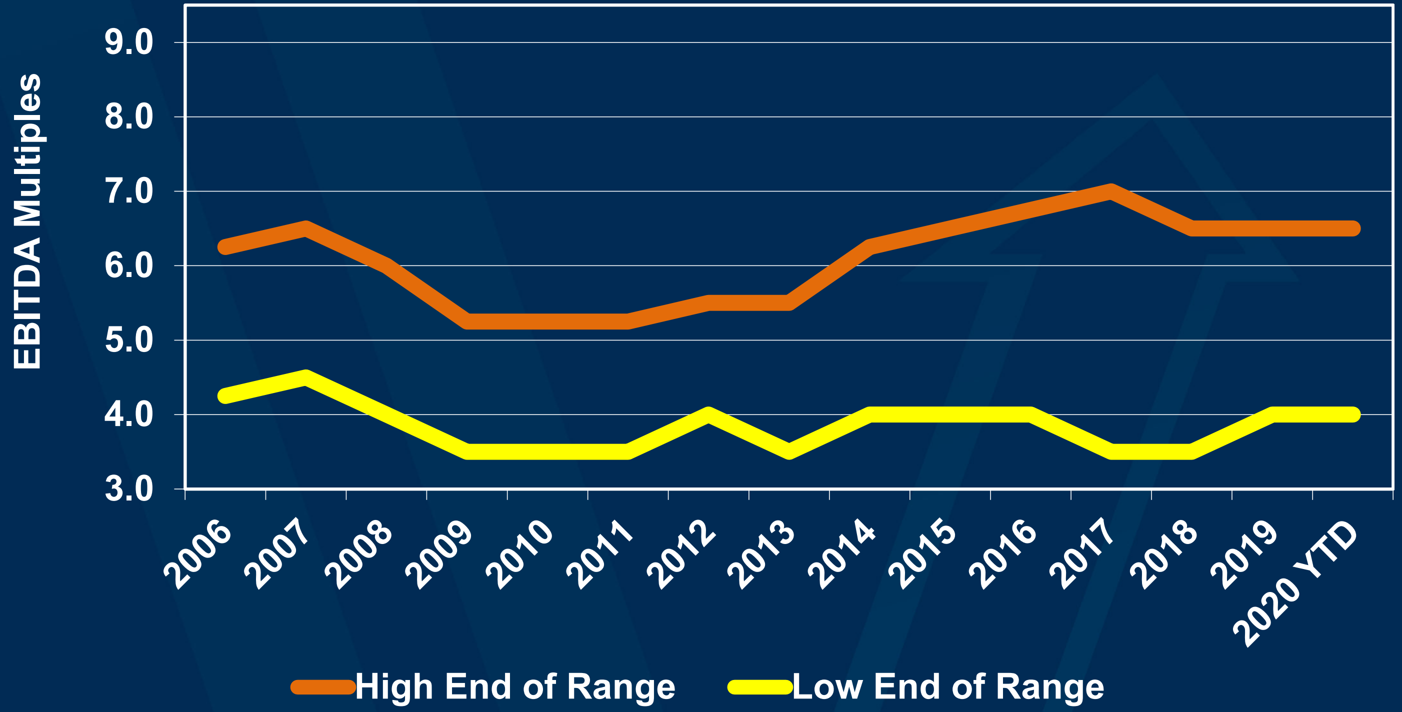
Historical Multiples Being Paid (Private)



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Asset Market Valuations – Tuck-In

<u>**Three Elements**</u>

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.

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Benefits/Risks - SELLER

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.

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Benefits/Risks - BUYER

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.

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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	$1,700,000		$900,000		($225,000)		$2,375,000	
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	$500,000		$200,000		($100,000)	B	$600,000	
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	$500,000		$200,000	10.0%	($50,000)	C	$650,000	
OPERATING INCOME	$100,000	2.0%	($100,000)	-5.0%	$525,000		$525,000	8.1%
NON-OPERATING	$25,000		$0		($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.

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Takeaways

- Hoard Cash!
  - Manage PPP Forgiveness
    - Adjust Payroll – Use Value Added Per Payroll Dollar to target appropriate payroll level.
  - Prepare for PPP Part 2
    - Sales level likely to determine forgiveness formula
    - Lobby Congress!
- Seek “Tuck-in” Acquisitions

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Questions?

Paul Reilly, *New Direction Partners*

Tel: (303) 520-7803

Email: PReilly@NewDirectionPartners.com

Tom Williams, *New Direction Partners*

Tel: (203) 856-0120

Email: TWilliams@NewDirectionPartners.com

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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 Cenveo, Inc. (NYSE:CVO), one of North America's leading printing firms. During his ten years at Cenveo, 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 Cenveo, 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 Cenveo from a collection of independent firms to an integrated graphic communication firm providing its clients with multi-media solutions. Under his leadership, Cenveo 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.

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Tom Wiliams

Tom Williams concentrates on Investment Banking Services and providing client companies with management, turnaround and restructuring support. He brings substantial management and financial services experience to New Direction Partners, based on his history of success as President of P.C. Leasing Corp., Executive Vice President of PhoenixCor, Inc., Vice President and Portfolio Manager at GE Commercial Finance and Vice President, Sales and Marketing for U.S. Concord, Inc.

Most recently, Tom was Managing Director of DoveBid Valuation Consultants Earlier in his career, he held positions of increasing responsibility in sales, marketing and product planning with the Graphic Systems Division of Rockwell International Corporation.

Tom holds an MBA from the University of Chicago and a B.S. in Graphic Arts Management from Rochester Institute of Technology. He is a member of NAPL's Soderstrom Society and a past President of the International Printer's Supply Salesmen's Guild. He is active in community affairs, charitable organizations and trade associations and is a speaker and lecturer at association meetings, industry seminars and universities.

Tom can be reached on his direct line at (610) 230-0635 ext. 704 or by email at twilliams@newdirectionpartners.com.

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