

# Inside the Thinking of Strategic Buyers and Search Funds

By James A. Russell

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As we've been reporting, much of the recent action in M&As within the packaging industry has been driven by private equity (PE) investment. PE investors like the solid returns they've been getting from their ventures into labels and packaging, and we expect their interest to remain high for as long as demand in these markets continues to grow.

But, we should also recognize significant activity among strategic buyers and search funds. Strategic buyers are owners of label and packaging firms seeking to supplement their organic growth with growth by acquisition. Search funds, representing buyers from outside the industry, are generating market momentum of their own as they set their sights on label and packaging producers.

A strategic acquisition aims at expanding the profile or the reach of an existing business, almost always with a permanent solution in mind. Unlike fast-moving, platform-building PE investors with target dates for cashing out, strategic buyers tend to proceed at a deliberate, one-step-at-a-time pace that suits their long-term visions for their companies.

## **Still a Force in the Market**

What we've been hearing from strategic buyers tells us that while the pace has lately slowed a little, the packaging market still has ample opportunity for owners who are determined to grow by acquisition. Behind most strategic acquisitions are one or more of the following business goals:

**Location.** For label and packaging firms, footprint often defines competitive strength. A Midwest-based client of ours that does a large volume of online sales wants to acquire a plant west of the Mississippi to better fulfill orders bound for the West Coast. The goal of another client is to operate a facility in each of the country's top 10 metropolitan areas, either within city limits or in the suburbs. Territory-specific strategic acquisitions will give both of these clients the geographic coverage that's key to their growth.

**Product mix.** A good example is a trend we're seeing among wholesalers of packaging supplies who want to establish their own credentials as packaging manufacturers. One such client has acquired a label company in its first foray into this product category. The client now wants to buy a boxmaking company for an expansion into custom packaging. These strategic acquisitions give the client more to offer than just commodity products – a move that should reward it with a larger share of its customers' business.

**Capability.** Companies acquiring on the basis of location tend to target businesses with capabilities similar or complementary to theirs. In most other cases, however, the buyer's objective will be to enter new markets without already possessing the equipment or the technology that serving the market requires.

That means buying a company that has the capability and operating it as an extension of the buyer's business. For example, a commercial printer equipped to print board stock can become a full-fledged packaging manufacturer by acquiring a company that also offers folding and gluing. Searching by capability is always a good tactic for narrowing the field of likely acquisition targets.

**Customer base.** At some point, the owner of a label or packaging business that has succeeded by catering to one market may begin to think about replicating that success in one or more adjacent markets. A client of ours who primarily serves automotive customers now wants to branch into labels and packaging for the pharmaceutical and medical equipment markets, which it has a limited ability to support. Acquiring businesses with full sets of tools for new types of customers gives buyers like our client the market access they want – as well as a hedge against a downturn in their main lines of business.

**Financial condition.** Not surprisingly, strategic buyers prefer financially stable, non-distressed companies that they can fold without difficulty into their existing operations. In today's M&A marketplace, an acquisition candidate with an EBITDA of 10% or more can expect to attract buyers willing to pay a fair multiple for the seller's business.

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Workforce. Along the same lines, what strategic buyers want to see in prospective new employees are solid experience and high-value skill sets. For obvious reasons, non-union workforces are more desirable than organized ones.

## **Search, and They Shall Find**

These are the main motivations of strategic buyers, which differ significantly in some respects from those of PE investors. There is, however, a third class of buyers for sellers to be aware of: those known in the market as search funds.

Search funds represent ambitious individuals who are out to purchase and manage existing businesses as the next stage of their professional lives. These buyers – very often people who have been successful in the corporate world – have substantial financial backing and a long-term perspective on the acquisitions they have in mind. Unlike PE investors, they have no predetermined exit strategies: they want to own, hold, and prosper in the same spirit that strategic buyers do.

Sellers entertaining offers from search funds will find them selective and methodical in their approach to doing business. Since most search fund buyers probably will have had no prior experience in packaging or labels, they can be expected to focus on the stability of the workforce and the willingness of the selling owner to remain in place during the transition period.

Sellers who can measure up to the expectations of strategic purchasers should prove equally attractive to search funds. Both types of buyers are active in the market now, and we foresee continued dealmaking on their part as more owners of label and packaging firms take their first steps toward being acquired.

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](http://www.newdirectionpartners.com).