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Stu's View

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M&A Today: Cashless Mergers and Tuck-Ins

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Printers frequently ask us, "What is happening today with Merger and Acquisitions?" The answer is "More than you think, and very different from prior industry downturns!"

If you research merger activity in the last recession of 2001-02, you will see two prevalent statistics – a greater than 50% reduction in number of transactions and a 50% reduction in EBITDA multiples from 6x to around 3x. NEITHER IS HAPPENING TODAY!

Today the number of merger and acquisition transactions approach historically high levels and EBITDA multiples are falling from a much lower peak, but in today's market, EBITDA multiples are just not that relevant.

In the prior recession, which followed the most robust merger and acquisition activity period in history, merger and acquisition activity came to a halt as the gap between seller expectations driven by then recent multiples and buyer reluctance driven by the fear of falling sales was too wide to bridge.

This is also happening today but the need to be more efficient is driving two merger and acquisition strategies – *Cashless Mergers* and *Tuck-Ins*.

CASHLESS MERGERS

Cashless Mergers are not new. Although they have been around for many years and are prevalent in many industries, they have occurred infrequently in the printing industry.

In a Cashless Merger the owners of two firms share ownership in the combined firm. Sometimes the ownership is equal but many times they are not. *Cashless Mergers* allow the synergies of combining two operations to be realized but without the implication of one owner being bought out. Agreeing on relative value is often easier as the agreed valuation methodology (or methodologies) is applied to both firms. For example, if the owners agree to use EBITDA as a valuation method, what EBITDA multiple is used is less important since the same EBITDA multiple is used for both firms.

Conversely, the joint owners must agree in advance as to how the new firm will be operating. These rules are usually evidenced in a shareholder agreement.

In addition for the need to be more efficient, the lack of the need for incremental cash is a major driver of *Cashless Mergers*.

Cashless Merger Benefits:

- **Affords realization of synergies**
- **Requires no incremental cash**
- **Less complex valuation discussions**
- **Banks' approval readily available**

The pre-merger banks will need to approve a *Cashless Merger*. However, because of the savings generated by a *Cashless Merger*, this approval is easily granted. In fact it is not unusual for the bank of one of the merged firms to request funding the combined firm. This situation is preferable as it facilitates integration and the requirements to co-mingle assets to implement synergies.

A very interesting variation that we see with *Cashless Mergers* involves the combining of two plants into one and the new owners continue to use two distinct brand names in the marketplace. We know of two such transactions under negotiation that mirror the joint production of two newspapers that have occurred in several North American cities.

The steps for completing a *Cashless Merger* (in order of recommended completion) are:

1. Agree on the Merger Benefits. When both parties understand merger benefits it is much easier to surmount the obstacles of a merger. THIS IS THE MOST IMPORTANT STEP.

2. Agree on Relative Valuation. One methodology or multiple methodologies can be used. Ultimately, the desired relative value can be achieved by manipulation of closing balance sheets through dividends or debt adjustments.

3. Agree on Social Issues. Both parties need to agree on ongoing management, brand, operating philosophy, operating procedures, location etc. It is highly recommended to hire an experienced independent party to assist in identifying and addressing social issues. THIS IS THE MOST DIFFICULT STEP.

4. Agree on the Communication Plan. This step is often overlooked but how and what you communicate to employees, customers, banks and suppliers is imperative for a successful merger.

5. Document and Close. This step should be completed in conjunction with competent legal counsel. Hire lawyers who understand mergers and acquisitions. Real estate lawyers and friends should be avoided.

TUCK-INS

Printers often say, “The value of my business is in its customers.” **The value of a printer’s customer base has never been higher!** In fact, today the value of the customer base and not EBITDA multiples are driving the purchase price of many merger and acquisition transactions.

Printers are closing by the hundreds. Some industry economists are predicting that between 5,000 and 10,000 printers will close during this industry’s downturn.

Many printers are not closing their doors and walking away, however. They are selling their book of business to a local competitor. Many are securing employment with the buyer of their book of business. This type of transaction is known as *Tuck-Ins*.

Tuck-Ins come in many forms but generally they have the following characteristics:

1. The buyer pays a commission for sales that are transferred from the seller, usually over a three year period. The percent commission varies but generally is higher for higher margin sales.
2. The buyer purchases at fair market value the equipment necessary to serve the new business and the seller is responsible for disposing the equipment not required.
3. The buyer assumes the responsibility for collecting the receivables and transfers collections to the seller. Both the buyer and the seller benefit when the buyer assumes the responsibility for collections. The percent of accounts transferred and the percent of accounts collected increases when the buyer collects receivables.
4. Employees essential to service transferred sales are hired by buyer – usually customer service and certain sales execs.
5. The seller is responsible for extinguishing remaining accounts payable and other debts.

The variations that we see with *Tuck-Ins* involve the buyer purchasing receivables at closing whose collection is warranted by the seller, or the seller being hired by the buyer usually to service transferred accounts.

TUCK-IN BENEFITS TO SELLERS:

- Maximizes Value of Business
- Potential Employment
- Preserves some employment
- Preserves customer relationships

TUCK-IN BENEFITS TO BUYERS:

- Virtually risk free
- Profitable Growth
- Drives Efficiency
- Expands Customer Base

Tuck-Ins are so popular with **sellers** because they increase the proceeds to the seller as compared to closing the door and liquidating assets. In addition, the seller can realize benefits from saving the jobs for certain employees and continuity of service for long-term and loyal customers as well as possible ongoing employment.

Tuck-ins are so popular with **buyers** because they are virtually risk free and represent the most efficient path for sales growth. In fact, profitable sales growth is more easily achieved through a *Tuck-In* as compared to slugging out it the market.

So if you are a buyer seeking to grow your printing business through mergers and acquisitions, be sure to investigate the tuck-in or cashless merger option. And if you are a seller, make sure you explore these options as well before just locking your doors and walking away. Working with a knowledgeable professional, either option can yield a profitable outcome for both sides even in today's economy.

This and other pertinent topics are discussed in our complimentary teleconferences, Cup O' Joe. The teleconference series for printers is offered by MargolisBecker each month. Details and registration forms for upcoming sessions are available at www.margolisbecker.com under the "Events" tab. Questions may be directed to Bonnie Pfaff at 888.577.1717 or bpfaff@margolsbecker.com

Stu's View is contributed by Stuart Margolis, CPA and Partner of MargolisBecker LLC to provide information that helps printing M&A, Cahfirms operate profitably. More information can be found at www.margolisbecker.com.

About MargolisBecker

MargolisBecker has long been recognized as the financial expert for the printing and allied graphic communications industry, assisting thousands of companies with strategic and financial management, valuation, mergers/acquisitions, accounting, audit and tax services. The firm is noted for its expertise in enabling printing companies to optimize profits. Proudly, it is the purveyor of the industry's *Cash is King*, and *Value-Added Principles of Management*, and compiles the annual Printing Industries of America Ratios, the industry's premier financial benchmarking tool.

About New Direction Partners

The team at New Direction Partners LLC has guided over 200 printing company owners through the sales and merger process. The advisory services reflect a full set of skills to help you sell or expand your business: valuation, management consulting, financial advisory and investment banking. The deep experience and industry expertise at New Direction makes it uniquely suited to serve printing, packaging and allied graphic arts businesses.