Stu's View

Contributing Editors:
Tom Williams, New Direction Partners and Stuart Margolis, MargolisBecker

Major Equipment Purchasing, Part 1: Plan Before You Purchase

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Making a major equipment purchase is always a thought-provoking, almost overwhelming process – and never more so than in the current economy with credit tight and so many printers struggling. On the other hand, the same pressures also open doors to opportunities for those positioned to take advantage of it. The marketplace is full of resale equipment that is fairly new as a result of business failures or lender repossessions; and manufacturer sales on new equipment are at the lowest level we've seen in a long time. So if your equipment is old, the prices are right, and you think that (just maybe) you can make it work financially – should you consider a major equipment purchase now?

There is no simple yes or no answer. Major equipment purchasing is never a "one size fits all" proposition. All critical purchasing decisions -- Used or new? Purchase or lease? Now or later? --- must be individually considered in light of market pressures and goals, as well as careful assessment of other critical decision making factors. This article will address the "purchase planning" portion of a major equipment decision. Major Equipment Purchasing, Part 2 will be tackling how to negotiate the deal and arrange financing.

MARKET PRESSURES AND MARKETING PLANS

Today's market pressures of fierce pricing competition and overcapacity make it tempting to compete in reactionary ways. Printers too often feel they must match the lowest price quote, or add new technology and services in the belief that "if you buy it, they will come." But in our experience, it is the lowest price provider who closes his doors, and the impulsive major equipment buyer who finds excess capacity with machines that are under-utilized and is operating at a loss.

Now is the time to prudently act, not just react. Take a step back, and start with the best tool in your arsenal – a solid, well-thought out marketing plan. A good marketing plan will help you focus on what you can realistically produce, and most importantly, the products and services that you can provide most profitably. Once you know what your service focus areas are or should be, you can look at equipping your facility to provide what your clients and the market will support. In making this assessment, your current client base is the best place to begin. Your competitive edge is the relationship you already have with existing accounts, so ask them what's going on in their companies and how you can help. Make yourself a partner in their success. Find out what they need and want, provide it if you can, then build upon that success by going to the marketplace with those services. If you don't have or can't develop the client base to utilize a particular piece of equipment, it doesn't make sense to invest your cash in it.

CAN I AFFORD IT?

Once it is clear what equipment you need to support your services, it's time to get out the paper and pencil and work on some financial projections. Consider the possibility and potential cost of rehabilitating your current equipment. Then do a cash flow projection with a new equipment purchase. The "Can I afford it?" question is closely tied to cash flow, which is one of the most important covenants you will see in any lending document.

The following Cash Flow Coverage analysis compares a printing company's current EBITDA (Earnings Before Interest Taxes and Depreciation) and Debt Service to those projected figures after a $500,000 press is added to the mix.

Equipment: Is it affordable?		
Cash Flow Coverage	**Current Operations**	**$500,000 Equipment Purchase**
Income Before Taxes	($10,000)	($25,000)
Depreciation	$250,000	$300,000
Amortization	$1,000	$1,000
Interest	$29,000	$49,000
EBITDA	$270,000	$325,000
Debt Service		
Principle	$221,000	$291,000
Interest	$29,000	$49,000
	$250,000	$340,000
Ratio	1.08	0.96
New Debt -Annual payments – over 6 years		
Principle		$70,000
Interest		$20,000

Column A shows a current income before taxes loss of $10,000, but EBITDA of $270,000. Total payments in this current scenario of Column A are $250,000, so the EBITDA covers the payments - barely. Typically, we see this happening more and more today.

Now look at Column B, with the $500,000 press purchased on the last day of the year. The new debt service has payments over 6 years of $90,000/year ($70,000 principle, $20,000 interest). Looking at next year's projections, we now see a $25,000 loss. Depreciation increases $50,000, but interest increases by $20,000, and EBITDA is now $325,000. With increased principle and interest, and debt service now at $340,000, the question to be addressed is: Where are you going to find that money? You can't count on sales alone to cover this. Analyzing and comparing your projected cash flow both pre and post-equipment purchase thus highlights why you should do a thorough economic justification for any new machine purchase consideration.

NEW VS. USED

When it's time to shop the marketplace – again, be thorough. As we mentioned, there's a glut of late model equipment out there at seemingly bargain prices and capabilities – but is that the right place to look for your particular needs?

- Talk to every reputable dealer whether you are considering new or used. Have each manufacturer educate you about their products. Be sure you totally understand the total cost of operation, including service contracts, cost of consumables, operator training programs, and environmental concerns. For example, some of the newer machines require special climate controlled rooms which add to the cost of installation, so be attentive with due diligence.
- Talk to other equipment users about their experiences, particularly those not referred by the vendor. Observe the equipment in operation, preferably at more than one location.
- For a used machine, ask about any warranties availability. We have seen some digital manufacturers charge as much as $25,000 to $30,000 for recertification, plus require agreements for consumables. There are a lot of costs involved in getting a machine up and running, so most printers who are successful in buying used digital equipment already have 1 or 2 of a particular manufacturers unit, and are looking to add capacity. A used machine can truly be a bargain if you are in a situation where you already buy a significant volume of consumables from a specific manufacturer, and are able to get some relief on the recertification. On the other hand, if you are a first time digital buyer, don't underestimate the value of the manufacturer's warranty and training support. It can counteract the sometimes hidden costs of used equipment purchasing.
- Explore a variety of scenarios such as how the increased efficiency of a new machine may possibly eliminate a shift and produce cost savings, or how the additional interest to be paid on a new machine will impact your cash flow.
- Throughout it all, keep your marketing plan and budget in mind as you shop. For every machine considered, ask yourself, "Does this machine meet my current and future needs? How does it fit into my operation as a whole? What savings can I reasonably expect to see from lower production costs and improved efficiencies? Is my cash flow sufficient to cover the expense? And most importantly, with all factors considered, can I really afford it at this time?"

Whatever equipment direction and purchase timing you choose, be sure it is done with full and careful consideration of your marketing plan goals as well as the costs and benefits of the purchase. Use the resources available to you in making your decision. Equipment vendors can be helpful in providing cost benefit information. An accountant knowledgeable in the printing industry can be invaluable in your financial evaluation. A well thought out marketing plan, coupled with a financial and operational pro forma projection which considers the implications from both a cost and production standpoint are both essential preliminary steps in making an educated equipment purchasing investment.

(*) "A Cup O' Joe is a complimentary teleconference series for printers offered by MargolisBecker on timely topics for the graphic communications industry. 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@margolisbecker.com

Stu's View is contributed by Stuart Margolis, CPA and Partner of MargolisBecker LLC to provide information that helps firms 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.