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Business Valuation

Preparation Tips

By Greg Mischio

The number of mergers and acquisitions continues to rise, with more investors than sellers. Printers who decide to sell must focus on the process involved in preparing a business for either a merger or an acquisition. Learning different valuation methods, researching potential investors, and recognizing the correct time to sell is critical.

Business Value

In Let's Buy a Company financial expert H. Lee Rust states, "establishing the value of a company is more art than science, and there are a wide variety of methods and calculations used for establishing the market value of a corporate entity."

Rust describes esoteric terms that valuation experts use—discounted future cash flow and net present value of future available cash flows. He believes the measure of corporate value is as simple as "the return my client can expect to receive from an acquisition."

There are generally three different valuation methods for a printing business. The valuation method is just one component of the sale. David Sokol, Warren Buffet's former right hand man, was fond of saying that financials are critical, but factor into only 25 percent of the decision. They are an indicator of past performance and investors are focused on future returns.

Nevertheless, here are some commonly used valuation methods. Within each of these, an independent, third party appraiser will use different techniques to properly assess a business.

The income approach assesses the net present value of the benefit stream generated by the business, or the discounted cash flow. The asset-based approach calculates the value by adding the sum of the parts of the business. The market approach determines the value by comparing the seller's company to other companies in the same industry, size, or region.

Within a valuation, Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITA), should be established right away. Rust states, "EBITA is the nominal cash flow generated by a business, independent of its noncash expenses, its method or extent of third party financing, or its tax structure." In general terms, this is the cash used to service a company's debt.

For reference, the purchase price is usually calculated as the EBITA multiplied by a factor of two to six, less the debts assumed by the buyer.

When these three approaches are considered, Sokol's reasoning is better understood. "What each of these valuations doesn't include is the seller's vision, the buyer's vision, human capital, client base, and core competitive advantage," says Rock LaManna, intermediary for the print industry/owner, LaManna Alliance. "Any or all of these could actually make a business worth far more than the company's appraised value."

Ultimately Determining Price

A number of different methods and tools help a company determine price. Within any of the methods listed above, a valuations expert may take into account the price-earnings ratio; replacement costs of assets, property, and management team; or the discounted cash flow, which estimates a company's current value according to its estimated future cash flows.

All of those approaches are great for the accounting department. But according to LaManna, "in a merger and acquisition between multiple businesses, one element that truly determines the added value is synergy throughout a print shop's workflow, both on and off the floor."

In a synergistic relationship, the combined value of a company is greater than the sum of its individual parts—the classic $1+1=3$ equation.

Both the buyer and the seller benefit from a merger, which is why synergy has such a profound impact on price. For example, if a buyer wants access to the seller's geographic client base, he may be willing to overlook a lower valuation than the one suggested by an independent appraiser.

With synergy being critical, keep in mind these win-win elements when determining the value of a company. The purchase price should be reasonable. The seller could expect a premium price above the market value when the critical elements are strategic, but neither party should expect to gash the other.

A cash transaction should be close to the mark. Since most small printers aren't publicly held, stock won't be the currency for acquisition. It's usually cash, so a seller shouldn't expect some astronomical value, as

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can be the case when stock options come into play.

Take a Warren Buffet approach. Buffet doesn't like buying anything he doesn't understand thoroughly. Whether the buyer or a seller, a synergistic partner should be complementary to the business, which can help effectively gauge the purchase price.

Who Will Buy?

A myriad of different investors are out there, buyers for a print-related company can be combined into three groups.

Bigger Printers and Corporations

Within this group there are the multi-million to multi-billion dollar companies. How did they get that way? For most of these organizations, mergers and acquisitions are the springboard for financial success.

"They think strategically and are looking for a distinctive marketing advantage with their acquisition," comments LaManna in regards to how these larger companies process information.

These investors tend to avoid smaller companies, unless the seller can fill a distinctive niche or create an innovative new product or service. Unlike the private equity groups, they are looking for a distinctive advantage in the print-related market. They built their business in this industry and they'll do whatever it takes to stay on top.

Private Equity Groups

Private equity groups think strictly in terms of return. They don't tend to have much allegiance to a specific industry, just the ones that are performing well. If a private equity group is interested in a business, it's generally because they see a positive return over a fixed period of time. Be forewarned, if the goods aren't delivered, a private equity group will show no allegiance to its investments. The ex-business is sold off to make room for the next dice roll.

Individuals Looking to Run a Business

For smaller print-related companies, these investors could be the sweet spot. If they need a strategic partner to help grow, an individual investor or another company could provide the cash, equipment, niche, or personnel to expand business properly.

"It also might be a nice exit plan for an owner of a smaller company who would like to keep the company going for the employees, but no longer wants to participate in the ongoing management," adds LaManna.

No matter which buyer is chosen, provide a pro forma statement and a company profile of the business. A synergistic fit is the best fit for long-term growth and success. Make sure the elements needed for a win-win are established, no matter who the buyer is.

Right Time to Sell

The best time to sell is when something appeals to a sophisticated buyer. But what does the marketplace want? The answer includes a combination of timeless attributes sought by investors. Investors love niche markets. It's much easier to buy into a niche market than to start or build one organically.

It's harder than ever to find highly-reliable, inspired, skilled workers. If a seller cultivated an efficient, effective workforce, it could be a prized property for the buyer.

This is an idea economy. A smart idea, aimed at the right market opportunity could be highly valuable to an investor. Entrepreneurs have ideas kicking around in their heads. Investors usually aren't looking for a fully mature company. More often than not, they like a business with plenty of room to grow.

Investors want to expand into new territories and grow their customer base without having to go through the blood, sweat, and tears it takes to actually get new clients. To a larger competitor from a different region, having an established customer base is an attractive and lucrative prospect.

Synergy

It's a synergistic attribute of a business that's going to make it attractive to an investor. Carefully analyze strengths. It only takes one investor to buy a company, so find a niche and package a business accordingly.

If the correct investor recognizes a company's strengths then the company is positioned as a worthy acquisition. It will be much easier to find the right synergistic buyer, who in turn should provide an easy answer to the question, "should I stay or should I go?"

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