

Mark Your Calendars!

February, 2005
General Membership Meeting
(exact date TBD)
LA area
(exact location TBA)

May 10, 2005
General Membership Meeting
Caesars Palace
Las Vegas, NV
(held the day prior to the IRgA Convention start date)

August 2005
General Membership Meeting
(exact date TBD)
Seattle Waterfront Marriott
Seattle, WA

October 5-11
55th Annual Convention
Sheraton
Maui Kaanapali Beach
2605 Ka'anapali Parkway
Lahaina, Hawaii

CONVENTION HOTEL INFORMATION:
Negotiated room rates are \$205.00 run of ocean, single/double occupancy plus appropriate taxes. Please note the hotel has a \$14.00 (plus tax) per room per night resort fee. Cut-off date for rooms is September 2, 2005. For room reservations call (808) 921-4645 and you must identify yourself as part of the Western Reprographics Association.

Succession Planning 101

In the twenty-five years that I have been with the association, never has "succession planning" become more critical as a business strategy than in today's competitive, and somewhat tenuous marketplace. It has become a strategy that must be reviewed and adjusted on a regular basis (at a minimum annually) and must become a focal point in a firm's business plan. Why this shift in emphasis now? Why then, as some experts say, has "succession", as a business strategy, seen a definite paradigm shift that can and should command as much time and effort as you spend on handling day-to-day business issues in addition to planning for the future? The answers to these two questions seem to fall under four distinct categories, which can stand alone as a business issue, or they can be combined to magnify their impact on today's business owner. The categories are:

Economics:

The issue of economics becomes more relevant as competition increases, profit margins shrink and the cost of technology (representing the cost of remaining competitive) continues to increase. Depending upon a firm's/managements "love of technology", this can create within a firm a negative economic hit based on obsolescence of the technology as newer and newer upgrades are being generated before a firm can (1) figure out which technology will generate maximum efficiency or (2) recapture any or all of its initial return on investment for that technology. The question becomes for the owner, can I remain competitive without upgrading my operation every 18 to 24 months and can I continue to generate a profit while being less efficient than my competitors who are investing in this technology? Tough questions with no clear-cut answers. How long will you continue to

watch profits slide before making a decision or having to make a decision? Note: No comment will be made regarding sales volume. Still hold to the theory that volume isn't nearly as important as profits. Just ask yourself which would I rather do... "\$10 million in volume making 1% profit or \$1 million in volume making 10%".

Current economic data is indicating that the real growth for our industry is not growing at the same rates that we enjoyed in the '80's and '90's, which on the West Coast was running in double digits. Projections are indicating real growth rates in the 4 to 6% levels depending on your market/product mix. While on the surface that seems positive, understand that that is for the entire industry. It does not take into account the growth in the numbers of competing firms, both traditional and non-traditional (see competition), nor the expansion or explosion in the amount of equipment being shipped to existing locations and its increased efficiency requiring more volume. While the pie is growing at a 4 to 6% rate, the numbers cutting into that pie is growing at twice that rate.

It doesn't take a genius to understand that even if there were no attempts to change pricing levels that based on the above scenario everyone's slice of the pie will be getting smaller...that's under normal business conditions. What happens if pricing levels decline? Think of it this way...with a gross profit margin of 35%; raise your prices by 10% you can afford to lose approximately 30% volume and still make the same bottom line. Cut your prices by 10% and you have to double your current volume. Which do you think will be easier to accomplish? Increase costs, decrease profits in a shrinking market...definitely can cause an owner to reevaluate his firm's future.

Competition:

As mentioned above, competition has never been keener (I don't have to tell you or remind

Corporate Sponsors



WRA update

your of this fact.). The number of firms competing in the marketplace has grown since the '80's and when coupled with their growth driven by technology/equipment and its increased efficiency it is of no surprise that we find ourselves in the most dynamic and competitive marketplace. And this situation will not lessen or change dramatically anytime in our future. Competition today will be similar tomorrow but only a little more so! (Stolen from a sailors saying on predicting weather.)

Economics of a firm is further impacted by the business phenomenon of the late '90's and early '00's mergers and acquisitions and the advantage created by these relationships in terms of the cost and access to money, increased buying power in regards to technology, and the perceived advantage in a competitive marketplace. While it all looks good on paper however, these advantages, both real and perceived, can be offset by other expenses which can be documented and intangible issues which cannot be measured making the final verdict still out, subjecting each firm to that one critical element that is needed to achieve success ...differentiation.

Just a note on differentiation. It is not driven by size, nor is it driven technology necessarily, it is, however, driven by management and its philosophy on how to do business, and the customers perception of how you are different in today's marketplace.

Our economics will be further impacted by those "New Comers", who by definition are non-traditional competitors, whom whether by dumb luck or by specific design are recognizing the value of our marketplace. Relationships created by the merger of Fed Ex and Kinko's and UPS and Mail Boxes Etc., in-plant operations in major stationary/office supply chains, Costco, etc., has the potential to impact our market hence impacting our economics.

Demographics:

In a nutshell...we are getting older! Looking back over the past twenty-five years, I grew up with many of you and we both have

watched dramatic changes to our industry from the transition to second-generation operations, to mergers to acquisitions to just firms closing their doors. Look about and you will realize that we are looking at the next generation of owners and managers who are in the twilight of their careers and making plans for their "second" life. The critical issue becomes, who succeeds us. Is it a family member, business partner, key employees, an outside buyer...each brings a different challenge to the table when we talk about succession. Based on what I have seen happening in our industry, that if you are looking at a ten-year timetable before retirement, you need to be planning your succession strategy today.

An interested fact regarding demographics about our industry is that the majority of our employee base is the result of inbreeding...no... not the one where eventually everyone is senile and has big ears...inbreeding meaning that someone in the firm either sired, hired or recommended individuals to come to work at their individual firms. Our corporate identity is based for the most part on the principle of "word of mouth" rather than an identity created by an image, a logo or public relations campaign. In the corporate world of the top 2000 firms, the image of our industry, Reprographics, and even Printing and Graphics, lies below everyone's horizon. Most of our employees who come into the industry from the outside of our "inbreeding" program is the result of us going out tripping them and dragging them in and once we have them...they never leave. (Must be something about the ammonia and toner.) Recognizing this phenomenon makes our "succession" strategy as part of our business plan even more critical

Clients

While technology has had a profound and dramatic impact on our industry, especially the last ten years, the most dramatic change that affects everything that we do is the new relationship with our clients. Quality, service and price are givens. The days of

WRA update

two out of three are long gone. The days of CBW (cash before work) are gone. Print on Demand means in a eight and out by five unless of course it is a rush job. Receivables in days are going up and heaven forbid if you send out an invoice that is not in the format that the customer demands...add thirty days to the process for each mistake.

How have we responded? We do it, just that simple. We make it easy for the customer or client to work with us...from our own individual web sites allowing real time interaction with our clients via RFQ's, and access to our internal scheduling data, to hooking up with offsite plan rooms, to expanding our FM capabilities (P.S. This is the opportunity for growth that both Fed Ex and UPS saw when buying Kinko's and Mail Box Etc.), etc.

Our relationship is driven by our attempts to make us different from the competition. It is these "value added" services that drive our relationship with our customers. You must provide quality, you must deliver on time and your price must be competitive, so your success is driven by your customer's perception that you are giving them more. How does this impact our succession planning strategy? By creating this distinction you will (1) survive in the short term; (2) be competitive in the marketplace; (3) be profitable; and (4) be around to have something of value to sell in the future.

The current relationship with our customers will continue as is and probably will only change a little more so in the future (see definition of weather by a sailor). In other words the market you see will in all likelihood be the market of the next ten years subject to the same demands and inconsistencies that we are experiencing today.

So you are probably saying to yourself so, how does this relate to succession planning process? It critical because it drives what you are going to be doing with your business in both the short and long term and drives your business plan. You need to understand what

is going on about you in the marketplace, where you fit in, are you competitive and what are your prospects. Why? Because it drives your business strategy? Succession starts with a question? What is my ultimate goal? Here are two basic scenarios.

First, concentrate on taking as much out of the business as possible, limit investment in technology, run the equipment past its real economic life, be a cost control freak and take those funds and reinvestment into one's personal portfolio. At the end of the economic life of the business, whatever I get for the business is a bonus because I already have mine. In this scenario the basic value will be based on the perceived value of the sales because guaranteed, the equipment will probably have no value.

Second, and the most preferred, is the creation of what I call "Business Wealth". Meaning a strong net worth or owner's equity value, having a debt to equity ratio of something better than 1 to 1, have a positive cash flow (which today is probably more important than profitability...cash management is the life blood of a business!), show a reasonable profit and is not a technology Neanderthal. There is something of value that someone would want at some point of time in the future. Not surprisingly, these firms in both the short term and long term have generated on average more wealth for (1) the owners and (2) employees these firms than in the first case scenario. It all comes down to how hard are you willing to work for it. That is the primary difference between the two scenarios.

Now that we have all decided on scenario number two, what next, what are the options that need to be looked at and how are these options going to affect my succession strategy?

Question number 1: Succession...to whom, how much and how do I get paid! Pretty much covers the basics...could add "how to minimize my tax hit" but that is a discussion for another time.

To Whom...options: (1) family or family member; (2) partner(s); (3) employees (key); and (4) competitor, client, or conglomerate of like and unlike firms. Each option has an impact on the process, which we will discuss in a moment.

But first we need to create a value for our business...what are the methods, how do we go about it, what valuation method seems to be in vogue today? You need to look at all options. Basically valuation methods fall under three basic categories and they are:

Note: if you are interested, the author has separate monographs on these methodologies.

Valuation Methods

An "On-going" sale means that you are selling the business in its entirety, the corporation to include all of the assets and all liabilities. Basis value consists of the Net Worth of the business. Added to that is a factor for the excess value of the equipment over the book value of the business and any remaining depreciation allowed for this capital equipment minus debt owed and finally a factor for Goodwill. Goodwill has little or no relationship to a firm's name or the length of time that it has been in business...it based on the profitability of the firm over time and its reinvestment back (defined by a firm's net worth) into the business over a period of time, normally five years. For those that were hoping for some multiplier number of sales as a methodology, this method, at least in the printing industry has been ranging between 35 to 45% of sales as a value.

"EBITDA" means earnings before interest, taxes, depreciation and amortization (meaning owners salary and perks) times some multiplier factor which has averaged 2 to 3 times the average EBITDA for a three to five year period. This is commonly referred to as a bulk sale approach. Here the seller sells all the accounts, equipment, inventory, goodwill and most everything else but not the corporation. The seller keeps the accounts receivables, accounts payable, taxes payable, etc. The assets being sold are generally the assets that produce income minus the working

capital components (cash, receivables and payables). The idea behind a bulk sale is that it creates a firewall between one entity and the next. Strategically, buyers prefer it because they can begin to re-depreciate (based on a legitimate appraised value) the equipment as of day one. Because this is really a negotiated type of sale, variations as to who does what is not uncommon so some of the items may switch from seller to buyer and buyer to seller.

The last methodology is nothing more than a firm "Selling" its accounts to another firm. The seller retains all other assets as well as liabilities and basically is being paid a commission for the successful transfer of their sales to another firm. For this type of negotiation having a "thick skin" becomes critical in achieving any level of success. Seller must be prepared to understand that the buyer wants none of the firm's assets, which also include the staff, and this can get the negotiations off on the wrong foot. The Buyer will probably diminish the "value" of the sales based on their version of what is net profit is and will want to pay the seller off at the end of the first or second year with the only guarantee that the sales records will be accurately maintained. No credit is given to the seller even if the buyers are unable to service an account through no fault of the seller, or the buyer screws up a perfectly sound working relationship and loses the account. Half the time they will contend that because they also sell to existing accounts that the seller shouldn't be entitled to some or all compensation because it was already their account...even if the product mix is different or that their contact with the account is transitory.

Buy/Sell negotiations usually begin like this: The seller is offered a 10% commission on all sales at the end of the first year, and 5-6% at the end of the second year. Some firms will offer 10 to 13% of the first year's sales only. The seller is penalized for slow pay accounts or accounts that go bad. (see what I mean about a thick skin.) If by

WRA update

this time the buyer isn't tossed out on the ear by the seller then the usual counter is something like this: Seller will accept a two to three year payout, paid quarterly with access to all monthly sales records, commissions normally running 12% for the first year, 8% the second and 5% the third year. There will be a required 10% good faith deposit paid up front and (here's the kicker) the commission is based on Value Added of sales (Gross profit Margin) and not net sales.

Final settlement usually ends up as follows: While the concept of Value Added is usually dropped as a basis for compensation both parties understands its importance. When these sales are added to a second or third shift the profit margins are substantial to the buyer. The seller sees Value Added dollars a negotiating tool that really represents the true value of their sales. Buyer concedes up front monies or good faith monies based on approximately 10% of the proposed total value of the transaction. Based on industry averages of similar type of sales (graphic arts industry), payout is made every six months to seller for a total of two years. Commissionable rates are close to 10% for the first year and 6% for the second year. Seller has access to sales records because their employment is usually part of the deal. Commissions can be increased based on sales figures that are higher than average (normally the previous three years) for these accounts. Commissions can become as high as 12% for the first year and 8% the second year. Bringing the owner or key sales staff on board does help to insure that existing levels of sales don't change dramatically especially for the worst.

Whatever methodology used the key concept is "due diligence", "due diligence", "due diligence". And that is for both parties. Seller needs first and foremost, to get a "non-disclosure agreement, preferably draw up by an attorney, have audited financial statements, access to both a business attorney/tax attorney/CPA (could be rolled all into one person), an accurate listing of all accounts

by sales volumes, gross profit margins, net profit margins, detailed equipment list to include leases, how long to run, payout figures, etc. Must have an idea of how much (numbers based on reality) one wants and how a deal is to be structured so that negotiations get off on a professional start. This will either spur interest in the buyers part or both parties just move on with little effort expended.

The buyer on the other hand must insist on documented financial records, access to sales records to also include state board of equalization records, and access to "key" designated employees to validate the claims of the existing ownership. The buyer must follow-up on the data presented and has their own experts review this material to verify its accuracy.

While understanding and doing an annual "how much am I worth" valuation for each method, the ultimate "valuation" methodology used will be based on WHO is going to take over this business. Remember we are looking for a win-win situation. That means the seller gets their money and the buyer lasting long enough to pay the seller while being able to make a living and have the resources to grow their business.

The WHO

The choices boil down to three: First and foremost are existing family member or members, but only if (1) they want it; (2) are capable of running the business; (3) able to get along to insure that one gets paid; and (4) arrangements are setup so that if there is a smooth transition of ownership, meaning all arrangements are setup prior to any tragic circumstances.

Second option includes (1) existing partner; (2) key employees; and (3) to the employees via an ESOP. If one is talking about an existing partner, there must be a pre-existing buy-sell agreement, which includes a defined management succession/operational plan in case of an unforeseen

WRA update

tragedy, a pre agreed value (which should be updated yearly) and agreed to payout program for either partner or their family members. Issues such how to pay for or buy out a partner should be discussed in advance and planned for in case of such a situation. Please note that when I say partner I also include traditional partnerships, Sub chapter S corporations and corporations... "partner" is being used generically to describe a relationship. These types of agreements do require professional assistance to include corporate attorneys and tax experts especially if payouts are to be complete via insurance policies or we are talking about trusts.

Arrangements when sold to key employees or employees via an ESOP program have their own set of issues to include an agreed value and payment schedule, the transfer of ownership, etc. Critical issue becomes the "guarantee" to the seller to insure payment while not strapping the firm financially in the short term, and insuring that the "new" management is able to control its own destiny... definitely a fine line is walked here between ultimate control versus whose is making the payments and that transition.

ESOPs (Employee Stock Option Plans) represents a third alternative, however, their success rate in our industry is less than a third and is usually not the method of choice. I know of two situations in which it has worked very well but only because the owner was willing to take his payout over time while turning over control to his hand picked employees immediately. Key elements to this successful buyout was that the payout wasn't onerous to the firm in terms of its yearly funding and the owner was willing to give up day-today control despite not receiving all of his funds upfront. Trust in one's employees becomes central to the success of the process and the willingness not to bankrupt the firm by entering into a funding agreement that is so one sided and financially onerous that the chances of success a minimized. This program only works with that "right" blend of ownership and employee where the driving force is operational and financial success and not ego driven.

The third option and probably the most prevalent is selling to a "third" party. Candidates include a firms competitor, customer (especially in a trade source scenario), a firm that wants to expand into new markets (same industry but different product/client mix), same type of firm but looking to expand into different regional markets and finally just the firm that is looking to emulate some of conglomerates in which success is measured by its number of firms and total volume/revenues. In over 75% of these buy/sell situations, the buyer is looking strictly for an "asset" sale (valuation method discussed under EBITDA), with 15% as strictly "sales" driven with the remaining being an "on-going" sale (Based on historical data compiled by PIA and PIASC over the past 5 years).

As you can tell by now, the "succession" process can, if not planned for in advance, prove to be a daunting and time consuming effort that may not result in a win-win situation for the seller. Being unaware or unprepared and not having succession as part of your overall business strategy for your firm can only lead to issues that you may not be prepared to deal with either professionally or financially. How important is this? Please read the following recap of a report done in 1999 by Arthur Anderson (when they were viable) on "Why so many family owned businesses fail to survive into the next generation?"

- Founder did not have an adequate estate plan in place – 98.8%
- Needed to raise funds to pay estate taxes – 97.9%
- Founder did not adequately prepare for the transfer of the business – 97.1%
- Conflicts with family members in the business – 89.7%
- Having a poor succession plan in place – 49.7%
- One or more key employees left the firm – 38%
- Insufficient training or exposure to key customers – 14%
- Technology changed and firm remained behind – 0.3%

WRA update

Interesting results! Note the importance placed on the lack of planning. Think about it!

I believe that in today's economic climate and certainly based on the competitive nature of our industry, everyone must be prepared to move on as some point in time. The who, what, when, where and why of the process needs to be addressed or at least begun now. In business schools across the country everyone talks about business plans, the one, three and five year business plan and how it is critical to a firms success or failure. Succession and planning for it is part of the business plan and you must incorporate it and embrace it as an integral part of today's business plan.

Questions, comments, contact Frank Iannuzzi at WRA, 323-728-9500 Extension 222. Frank has been with the associations, WRA and PIASC for over twenty-five years working with members on all issues impacting their sales and marketing efforts as well as issues that can impact the financial health of their business. He has a B.S. degree in Business Administration and an MBA with an emphasis in finance.

President

Mr. Greg Betty

Studio Blue Reprographics, Inc.
7132 A Johnson Dr.
Pleasanton, CA 94588
Phone: (925) 463-9660
Fax: (925) 463-0327
Email: gbetty@sbgraphics.com

Treasurer

Mark Sipes

Consolidated Reprographics
345 Clinton St.
Costa Mesa, CA 92626
Phone: (714) 424-8500
Fax (714) 424-8503
Email: msipes@consrepro.com

Director (Idaho)

Mike Mahan

Blueprints + Plus
4082 Chinden Blvd.
Boise, ID 83714
Phone: (208) 342-4141
Email: mike@blueprintsplus.com

Supplier Director

Mr. Tom Elliott

Oce' Imaging Supplies
1674 Heritage Circle
Anaheim, CA 92804
Phone: (714) 778-1670
Fax: (714) 778-1681

Past President

Mr. Odie Duggan

OCB Reprographics, Inc.
17721 Mitchell North
Irvine, CA 92614
Phone: (949) 660-1150
Fax: (949) 975-1482
Email: odied@ocbinc.com

Vice-President

Dave Morales

Right Angle Digital Print
10855 SW Cascade Blvd.
Tigard, OR 97223
Phone: (503) 620-3691
Fax: (503) 620-3889
Email: dave@rtangle.net

Director (Canada)

Mr. Mike Shemilt

Island Blueprint Company
905 Fort St.
Victoria, BC, Canada V8V3K3
Phone: (250) 385-9786
Fax: (250) 385-1377
Email: mshemilt@islandblue.com

Director (Washington)

Mr. Eric Watt

Bill's Blueprint, Inc.
2920 Rockefeller
Everett, WA 98201
Phone: (425) 259-0859
Fax: (425) 258-6877
Email: ericwatt@billsblue.com

Supplier Director

Mr. David Gilman

Image Products of California
22915 Savi Ranch Parkway
Yorba Linda, CA 92887
Phone: (714) 282-5678
Fax: (714) 282-5680
Email: david@imageproductsca.com

Past-President

Ms. Gina Hess

The Copy Company
616 6th Ave. South
Seattle, WA 98104
Phone: (206) 622-4050
Email: gina@thecopycompany.com



**Western Reprographics
Association, Inc.
2004 – 2005
Board Members**