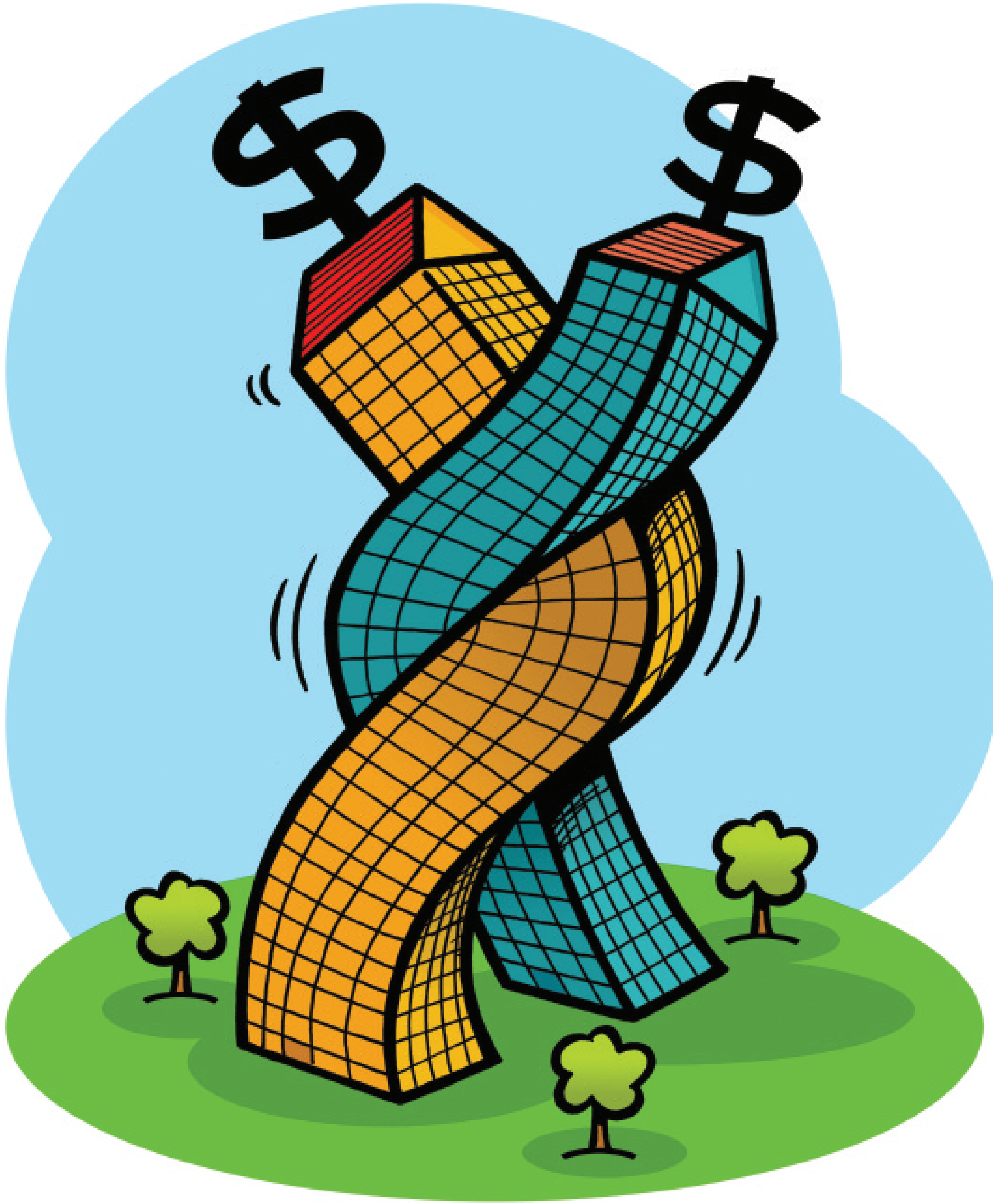

The Consolidation Effect

Mergers and acquisitions are on the rise. Here's how the trend is reshaping the industry and affecting distributors and suppliers.

By Lisa Bennett

When is it time to sell? It's a question that business-owners grapple with every day. Economic lows and economic highs often provide easy answers for many. But when the economy is in somewhat of a standstill, as it is now, the decision is a bit more difficult to make.

In the promotional products industry, that decision is often determined by lineage. It's the precise moment when a family business has no more obvious successors. Such was the case recently for Kwik-Klik (*asi/65922*). Kwik-Klik, based in Brooklyn, NY, was a family-owned business that annually sold approximately $3 million worth of promotional pens. But, Kwik-Klik recently found itself with no family members interested in taking over the business, so selling seemed to be the best option for owner Ida Cooper.

Last year, Bullet Line Inc. (*asi/42424*) purchased Kwik-Klik. While financial terms of the deal were not disclosed, Bullet Line has kept the acquired firm intact and now promotes it as "Kwik-Klik, a Bullet Line company."

Bullet Line CEO Jeff Kramer says the acquisition was a natural for his company, a $57 million supplier. With an already eclectic mix of promotional products, the addition of Kwik-Klik enhances the company's overall offerings to the market, Kramer says.

"Bullet Line is defined as a service company because we cover so many product categories," Kramer says. "While most people think of us in terms of the originator of the three-day rush service, pens is our largest product category as well as our largest category for growth. So with our resources in pens combined with our service, we thought it would be a good match and that we would be able to take Kwik-Klik to the next level. We are able to invest in this product line and continue its growth in the industry."

And that strategy of investing for growth is quite common today – in the promotional product industry and in the overall economy. In fact, the amount of money spent on mergers and acquisitions in the United States was up 28% in 2005, according to mergers-and-acquisitions tracking firm Dealogic. And, the Association for Corporate Growth (ACG) predicts that the amount of deals in 2006 will surpass that of 2000, when deal-making reached an all-time high. In a new survey of corporate chief financial officers, ACG found that more than 80% rate the environment for mergers and acquisitions today as good or excellent.

Even further, and more applicable specifically to the promotional products industry, 19% of those surveyed by ACG believe that manufacturing and distribution is the one sector of the economy that will experience the most mergers over the first six months of 2006.

It's a statistic that's certainly noticeable in this industry's recent merger-and-acquisition activity. "Bigger isn't always better, but right now it's hard for industry companies to compete if they don't have enough resources behind them," says promotional product consultant Fran Ford, president of Ford-Howsmon, based in Phoenix. "There's bound to be some consolidation for both distributors and suppliers. It comes down to survival of the fittest. On the supplier side, you just can't compete these days unless you're big enough and have enough capital behind you. This will force companies to merge. And on the distributor side, the smallest companies are facing a hard market right now. Suppliers are asking for a lot of cash upfront on many deals, and they often can't do it unless they have a bigger partner or owner."

> **"There's bound to be some consolidation for both distributors and suppliers. It comes down to survival of the fittest."**
>
> – FRAN FORD, PRESIDENT, FORD-HOWSMON

Within the past year alone, some major acquisitions have occurred on both sides of the industry's fence. *Counselor Top 40* distributor Geiger (*asi/202900*) bought Synergy (formerly *asi/340874*), American Solutions for Business (*asi/120075*) merged with Health Print Ltd. and 4Imprint (*asi/197045*) sold its ownership stake in Adventures in Advertising/AIA (*asi/109480*) to a private equity firm. Big merger activity was even more pronounced on the supplier side. EBSCO, which already owns Admanco (*asi/32360*), Four Seasons Garment Co. (*asi/55200*) and Vitronic (*asi/93990*), recently added Crown Products (*asi/47700*) to its promotional products network. Also, Polyconcept purchased Leed's (*asi/66887*), and most recently Garrity Industries (*asi/55980*) was bought by the Duracell division of Procter & Gamble.

Yet, while mergers and acquisitions are certainly on the rise, some experts believe the industry won't go through true consolidation. According to Michael Woody, president of industry consulting firm International Marketing Advantages, we may see an increase in some mergers and acquisitions, but in an industry with a low barrier of entry, it's nearly impossible to see massive consolidation.

"I think it just can't happen," Woody says. "The fact is, if I wanted to hang out a shingle tomorrow and become a promotional products distributor, I could do that. And with such a low barrier of entry into this industry we are going to have a constant stream of new distributors making over-consolidation almost impossible."

Woody says that industry suppliers have a similarly low barrier of entry, but they have to make a greater investment in inventory before they go to market. "It is a little more difficult for industry suppliers to jump into this industry," says Woody. "But there will always be a pool of retail organizations that either contract out or purchase equipment for decorating services, for an easy entry into the promotional products world."

Indeed, an analysis of the sales of the biggest suppliers and distributors in the industry bears out Woody's assessment. In 1992, the *Top 25* distributors sold 18% of the industry's total sales volume, while in 2004 the *Top 25* sold 17%. In 1992, the *Top 25* suppliers accounted for 14% of the industry's business, while two years later that number only rose to 17.5%. So, while mergers are on the rise, the increased deal-making has not resulted in the biggest players accounting for the biggest piece of the pie. "Just because the industry is difficult to consolidate does not mean that merger and acquisition activity has not increased," Woody says. "That activity is driven more by the state of the economy in general. So, right now, there is an increase in mergers and acquisitions, but that does not necessarily mean that this will consolidate the industry."

What it will do, though, is change the face of both suppliers and distributors. Here, we talk to executives with industry firms that have recently gone through mergers or acquisitions to find out how the deals affected them, and to see what they think the effect on the industry overall will be.

A Better Client Experience

Marc Simon, president and CEO of Halo Branded Solutions (*asi/218450*), has negotiated some of the largest mergers in the promotional products industry. Simon says merger activity in the industry has increased for many reasons, including economic instability, but with that instability comes opportunity and the need for change. And Simon believes that the end result is higher profit and less overhead for the distributor and end user.

"The smaller industry distributors simply can't be competitive when it comes to offering the technology that larger distributors can offer to meet the growing demands of the end users," says Simon. "Larger players can spread their fixed costs over more transactions making it a more profitable operation for a wider range of services," he says.

While Simon contends that there are a healthy number of mergers taking place in the industry, he, like Woody, doubts that overall consolidation will result.

"I do believe we will continue to see consolidation in the industry, which will result in better services for less cost," says Simon. "But there will always be that pool

6 Steps to a Successful Merger

When two companies decide to merge, the questions on the collective minds of all involved are simple: How long will it take? How much will it cost? And, in the end, who is left standing? Establishing a merger strategy is step one in the process. Marc Simon, president and CEO of Halo Branded Solutions (*asi/218450*), has been through several successful, and some less-successful mergers. Here, he offers a six-step program for a successful merger.

1. Understand the business.
It may sound simple, but you have to look at the stability of the customer base and the likelihood that the sales force will stay. Analyze gross margin, revenue and the average order size. Look at the amount of resources that have to be allocated to the new company and whether or not they have to be at the local level – this is sure to be a drain on profits.

2. Map out a forecast.
Build a picture of incremental profit and loss and make sure everyone involved understands that picture. Getting all the principals on the same page at this step is crucial.

3. Formulate a fair offer.
Good acquisition deals should be a win for both sides. If the acquirer is simply looking to take advantage, then the chance of a successful end-result aren't good.

4. Create trust early on.
Any purchasing company needs to work with the owner of the target firm to build a relationship of trust and confidence in the new organization.

5. Woo the sales force.
Salespeople cannot be neglected. Make a plan targeted to the sales force and make sure they understand why the merger is beneficial to them particularly as it relates to earnings. No distributor merger can work without sales force buy-in, as the quickest route to failure is to alienate the sales force and lose clients.

6. Overcommunicate.
It's vital that employees of the newly acquired company understand what is taking place and how it affects them. Create a plan for transition, stick to it, and communicate to the back office staff in plain language exactly what will happen to them. Be prepared to offer retention bonuses to maintain service through the merger.

"I do believe we will continue to see consolidation in the industry, which will result in better services for less cost."

– MARC SIMON, PRESIDENT AND CEO, HALO BRANDED SOLUTIONS

of smaller distributors and new distributors coming into the industry."

Yet, Simon firmly believes that it's the end-user who benefits when small companies become bigger in the promotional products industry. A recent Halo acquisition, JII Promotions (formerly *asi/232427*), a deal that was completed in January 2004, proves this point to Simon.

"When we looked at JII, we saw a company doing over $40 million in annual sales and actually losing money," says Simon. "We knew it was a good opportunity for both Halo and JII."

Simon's main focus once JII was brought into the Halo fold was quickly eliminating any crossover costs so that JII could become profitable. It's this step, he says, which produces the most positive results of any merger or acquisition. Simon's initial focus was the sales force, as he believes that if salespeople are happy and paid well then their clients will receive better service.

"Once the decision was made to acquire JII, we focused on the sales force, looking at volume, gross profit and average order size," says Simon. "JII had approximately 150 people in Ohio and a few hundred salespeople across the country. But when we layered their business into ours, we found we could provide high quality service by only adding 35 people to our organization."

Painful cuts, obviously. But, necessary ones. The only way for positive outcomes to result from an acquisition is to make every aspect of the deal profitable. This, in turn, allows the now bigger organization to pass savings on to customers. "It turned a losing operation into a profitable one on an incremental basis," says Simon. "That deal would only work if our compensation structure was better for the sales force than the plan at JII. We are able to negotiate better pricing from our suppliers and rebates that we pass on to our salespeople. The combination of rebates and special prices allowed the JII sales force to increase their commissions by 10%."

Others agree, saying that the only way that mergers and acquisitions can have a real positive impact on the industry as a whole is if the effect is a better overall experience for clients. When distributors merge, the natural expectation would be lower prices and greater selection for the end user. Joe Chandler, chief business development officer of mergers and acquisitions for Proforma (*asi/300094*), says demographics in the promotional products industry are changing and that is having an effect on the trend of mergers and acquisitions.

"We are an industry that, like many others in the U.S., is getting older," says Chandler. "Smaller shops are looking for an exit strategy to plan for their retirement. We see many family-owned businesses where the second or third generation simply doesn't have the passion for the business that the founders did and may not want to come in and take over, so the owners are left with a viable business. Merging with a larger organization may be the best solution for them."

And Chandler views this as a good thing, as customers will receive volume pricing by purchasing multiple products from one distributor. "That is a benefit for our end users," he says, "who are able to get a variety of products and services from one supplier."

On the supplier side, that's something that Bullet Line has noticed following its recent purchase of Kwik-Klik. Kramer says most feedback from distributors on the acquisition has been positive.

"Distributors say that now they are dealing with a much more sophisticated operation and service-oriented company," he says. "It also makes it easier for the distributor when they are able to get a variety of products from one supplier. It makes the whole process simpler for the distributor rather than calling on several suppliers."

Merger-and-Acquisition Fallout

While industry mergers often result in better experiences for distributors and better pricing and service for end-users, the trend can also produce some backlash.

"Supplier acquisitions may look like a good idea on the outside and often they are very successful," Woody says. "But they also come with their own set of issues. They do offer a one-stop shop for the distributor, but they may also face delivery issues and growing pains that come from being an industry giant."

Ford, though, believes that the biggest possible change on the supplier side is increased competition. Not that that's a bad thing, he says. "When there are fewer firms in any industry, competition gets more fierce," he says. "But it's good for these businesses to be on their toes every day. They need to constantly be pushed, and the more mergers there are, the smarter these companies will have to be."

On the distributor side, the biggest fallout might be the disappearance of the smallest companies. Yes, the industry has a low barrier to entry and new one-person shops will continue to sprout up, but it is getting harder and harder for these companies to compete. "Big deals are a near-impossibility for small distributors these days," Ford says. "Suppliers ask them for a lot of upfront cash and then their clients hold out payment for 60 or 90 days. That kind of cycle can put a small company out of business. They need a bigger partner right now to effectively compete."

Proforma's Chandler has noticed the trend, and believes the consolidation of the smallest companies could be the outcome. "Sure, it may be better for the end user if they can get a lower cost on their products and have a larger variety of products," says Chandler. "But it's the Wal-Mart mentality. It becomes more difficult for the smaller local distributors to compete, so the departure of the smaller distributor may be the downside."

Maybe the biggest concern during a merger process is loss of business. And, the quickest way to lose business is to lose salespeople – a natural occurrence following an acquisition. "In an industry where so much of the business is built on relationships, it can be a tough sell for distributors looking to sell their company," says Woody. "There are no guarantees that the salespeople will stay with you in an acquisition and ultimately, that's the greatest asset of any distributor organization."

That's something that Simon was well aware of when he engineered the JII acquisition. "If you don't keep the salespeople, the merger is a dismal failure," he says. Simon knew the key in retaining the sales force was through an improved compensation plan. "We are able to offer a better compensation package to our sales representatives simply because of the size of our organization," Simon says. "We get better prices from our suppliers and rebates that we pass along to our salespeople. Ultimately, it benefits the salespeople to stay."

Yet, planning a retention strategy takes more than just an improved pay plan, according to Simon. And in this case, it worked, as Simon says that the attrition of the JII sales force was negligible. "Before we announced our plans, we used feedback from the JII managers to make sure they were on board and put together a program we were certain would be attractive to their sales force," he says. "We make a commitment to our sales force to offer the best possible customer service, marketing tools and technology. We want to give them every incentive to stay."

Lisa Bennett is a freelance writer based in Chicago.

"Why I'll Never Sell My Company"

One distributor has been through the merger wringer and swears he'll never do it again.

Glen Colton, president of Seville Marketing Inc. (*asi/323798*), has been a part of two mergers in his 20-plus-year career in the promotional products market. Once, he was a salesperson for a company that was sold, and another time he was the owner of a company. Both deals were disasters.

"You would have thought that I would learn my lesson from the first time, but no," Colton says. There's something unseemly about mergers where the purchasing company just tells the owner of the acquired company what he wants to hear. But none of it is true."

Although mergers and acquisitions are certainly on the rise within the promotional products industry, there are some small-business owners who simply will never sell their companies. Count Glen Colton among that group. As the owner of a small distributorship in Atlanta, Colton wants to be his own boss. He wants to control who he does business with and who his clients are. And he believes that he couldn't do any of this if he merged his company with a larger one. "On a scale of one to 10, where 10 is I'd definitely sell and one is I'd never again sell if my life depended on it," Colton says, "then I'd be a one."

Colton's strong views come from the sale of his distributorship at the end of 1999. Having grown tired of managing a sales force and overseeing his own business, Colton was receptive when he was approached with a deal by the owner of a larger company in his area. Colton would bring himself, his clients and some of his operation to the larger company, and in return he would get some ownership in the firm. What he didn't know is that this company wasn't paying its bills on time, was making poor business decisions and had an owner who wasn't willing to listen to anybody else's ideas. "It was horrible," Colton says. "I had 20% ownership of the company, but I was treated like an entry-level employee," he says. "I learned right then that unless you own 51% of a company, you may as well own none of it."

So, Colton left three years after he sold his company and started his own firm again. Now, this company, which he runs with his wife, will most likely be his for life. "To me, the concept of a merger is pointless," Colton says. "You go from a position of 100% responsibility to nothing. That just doesn't make sense to me. I think people who merge are either desperate or stupid." – *AC*