INTERVIEW

The Past, Present and Future of Copier Dealer Acquisitions

Former IKON Acquisitions VP Talks About the Glory Days of Deals & What's Happening Today

Michael Dudek
President & CEO
Zygoquest Group

It's interesting to get beneath the veneer of "common wisdom" in an industry. A decade ago, when I launched The MFP Report, the "common wisdom" was that the era of independent copier dealers was coming to an end. There was a widespread belief that small entrepreneurial dealers were an anachronistic distribution model. Mass consolidators like IKON and Danka, along with growing direct sales operations, were expected to push copier dealers into the fringe, and the advent of digital technology was seen to be the final catalyst.

Fast forward to today, and the "common wisdom" holds that the days of copier dealers buying and being bought has passed. While it's true that the volume of deals doesn't match that of the 1990s, there's still a surprisingly large volume of smaller transactions and a few bigger ones.

To get a better understanding of dealer dealmaking in the past and present, we spoke this month with an expert, Mike Dudek. After joining the old Alco Standard twenty years ago, Dudek in the mid-1990s oversaw the purchase of more than 300 copier dealers to create what remains the largest independent office equipment sales channel in the world. A couple of years after leaving IKON in 2001, Dudek put out his own shingle under the name Zygoquest Group. Today he and his firm are quietly working with companies who are acquiring copier dealers, and with copier dealers who are seeking to be purchased.

Dudek provided an interesting and opinionated view of what's worked when it comes to acquisitions, as well as what hasn't. He also shared his insights as to the opportunities and pitfalls of doing successful acquisitions today.

Thumbing Through History

MFP: *What was your background before joining Alco?*

DUDEK: I joined Alco back in 1984. Before that, I was a CPA and had spent five years as a US Treasury agent.

MFP: *What was Alco like in those early days?*

DUDEK: Alco was an old-style conglomerate that got its start in the 1970s. The concept was to buy-out entrepreneurs whose companies were reaching a certain size and stage where they needed expertise in areas like banking, cash management, financing, legal, and government relations. Alco bought companies in several industries — aerospace, drug and pharmaceutical distribution, paper, food service. There were eight different industry niches. All of them were either in manufacturing or distribution.

MFP: *How did Alco start buying copier dealers?*

DUDEK: Over time, paper distribution had become Alco's largest group. The Xerox patents had ended. Japanese copier vendors were entering the US market. The distribution channel was very fragmented. Alco bought its first copier dealer around 1982. It was a company ironically that was located in Rochester. Alco liked the business model and the stage of the copier industry at that time. Alco gradually exited most of the other industries in which it was involved. Eventually, that left the copier dealer business, which became IKON, and the paper distribution business, which was spun off *[in 1996]* as Unisource.

MFP: *How did you personally get involved in Alco's acquisition of copier dealers?*

DUDEK: In the early 1980s, Alco had bought a handful of copier dealers. They were a decent size. One of them was in Sacramento. It was 1983. Alco came to suspect that there was some fraud in that dealership. I was working for Alco corporate and was sent to Sacramento as part of a team to investigate that dealer. It turned out that there was significant fraud, and Alco took a $20 million charge as a result. That was my 'education' in the copier business.

John Stuart was brought in to Alco Office Systems in 1985. He did 15 or 20 more deals. He eventually was promoted to run Alco Office Systems. I was involved in more and more of the deals, including Alco's big purchase of Hillman. In 1993, I became Vice President of Acquisitions, right about the time that Alco was making its purchase of Erskine. I held that position until 1998. During that period I did something like 300 deals in office products and document services and another 50 technology services deals.

MFP: *What was the philosophy back then at Alco and IKON with regard to buying copier dealers?*

DUDEK: The whole philosophy was 'autonomy of operations.' We wanted to maintain the entrepreneurs ... or replace them if necessary. There was a combination of core companies and smaller dealer fold-ins. Alco provided support with corporate services. There was some effort at sharing best practices, but for the most part the entrepreneurs had a lot of latitude in what they did.

MFP: *The primary growth strategy was to gain geographic coverage?*

DUDEK: Yes. For the most part, we focused on the US and Canada. I think we had one dealer in Mexico. There were also selected operations in Europe ... the UK, Denmark, Germany, France.

MFP: *How would you characterize the results?*

DUDEK: We were generating good internal growth of about 13% per year. We had extremely good profitability. Essentially, we were buying profitable companies in a growing market and reducing the administrative costs.

MFP: *So what happened to change all that?*

DUDEK: Alco was doing well and the stock started attracting more attention. Outsiders — accountants, bankers, etc. — were telling management they should centralize to cut administrative costs from 15% to 10% of revenue. The expectation was that this would have a big positive impact of profitability, which would boost Alco's market capitalization from $4 billion to $7 billion. It was the first time

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This coincided with the decision to spin off Unisource. There had originally been some expectation that the copier business and the paper business would complement each other, but it never happened. There was never really any attempt to leverage the customer base. The feeling was that Unisource was holding back Alco.

MFP: Why didn't the plan work as expected?

DUDEK: The whole idea was based on centralization in order to be more cost effective. A big problem was that the type of entrepreneurial management you had that was successfully running $20 million locations was not the same as what you needed to run centralized $100 million regional companies. There were no tools or processes in place. It created chaos for customers and for employees.

There were bad attempts to put systems in place. The company — which by this time was IKON — bought source code from OMD to create some kind of system. Then there was the failed attempt to implement SAP. That resulted in a $15 million write-off. Unfortunately, the advice of the outsiders when these problems emerged was to go even faster.

MFP: This was also the time when IKON started acquiring technology companies?

DUDEK: Yes. We were being told that digital copiers were going to require all sorts of new skills to sell and support. However, it was clear to me that these technology companies IKON was buying were very different from the copier dealers we were used to buying. Many of them weren't even profitable. I raised objections, but I was overruled. These deals were all justified as being 'strategic.' We spent $250 million to buy $500 million revenue. Most of those companies have since been sold, closed or folded in.

MFP: How and when did the deal-making finally end?

DUDEK: In 1998, several of us executives were sent to the field to find out what was happening. We started looking through the books and found lots of problems. IKON took a $100 million charge in 1998, and that's when all hell broke loose. There was the stockholder suit *[which was settled for $111 million in 1999]*, and then the management team left. That's when the acquisitions finally ended. I became VP of Finance later in 1998.

MFP: Then what happened?

DUDEK: IKON proceeded to spend hundreds of millions of dollars on internal efforts and changes. Unfortunately, the company lost touch with the customers. The decision to go with Canon and Ricoh was also a problem. As much as one-third of the company's business was with other vendors. And this was at the same time that Canon and Ricoh were growing their own direct business. IKON got too focused on professional sales, and lost a lot of the up and down the street business that had made the company successful. In addition, the focus on bigger accounts meant lower margins.

MFP: How do you see IKON today?

DUDEK: I think they've finally stabilized. I think their leasing deal *[the recent sale of IOS Capital to GE]* was a short-term gain that could cause a long-term problem. I also think the sum of the parts is still greater than the whole.

MFP: Any views on Danka or Global?

DUDEK: I think Danka is fully valued by the market. Their service is eroding and will continue to. The old Kodak business is drying up. They have to close branches or buy dealers. They can't stay where they are. Global has done well, but they're getting to a size where issues can arise.

Life on the Outside

MFP: What have you been doing since you left IKON?

DUDEK: I really like the copier business, and I think I know it as well as anyone out there. So, after a breather, I started working again with acquisitions. I've represented buyers as well as dealers interested in selling.

MFP: Who's doing the buying these days?

DUDEK: You have a few obvious companies, such as Global, Toshiba and Imagistics. There's also been an upswing in CDA-type dealers *[larger independent dealers who are members of the Copier Dealers Association]* buying other smaller dealers to expand. There's a lot more activity out there than most people realize. There are deals of various kinds happening every week. There are dealers buying printer service companies. There are also some disgruntled dealers who want out, either because of growing margin pressure or because of family reasons.

My goal is to be in the middle of more deals. I originally was doing more business with buyers, but this year I'll end up doing more with sellers. The challenge for sellers is that buyers have more experience buying than sellers do selling. That's where my expertise can help.

MFP: What kind of mistakes do sellers make?

DUDEK: Sellers often give information to would-be buyers before they should, or they don't present that information to their best advantage. For almost all copier dealers, their company is by far their most valuable asset, but most don't know within twenty percent what that asset is really worth. One of the things I do at Zygoquest is to prepare a valuation report for the owner. I also make recommendations on how the dealer might enhance the value of the dealership in anticipation of a future sale. It's a higher-level analysis; not the nuts and bolts of the business.

MFP: Is there such a thing as a "typical" deal today?

DUDEK: Not really. They come in all shapes and sizes. Valuations as a multiple of sales are where they've always been. Global rarely pays more than one times sales. There's a perception that Toshiba may be paying a little higher multiple, but that may not necessarily be the reality. ROI expectations also haven't changed much.

MFP: What's you assessment of how feasible it is for a manufacturer to buy a competing dealer and convert it?

DUDEK: It's an excellent strategy, but it requires ongoing effort. You can't force existing customers to change. You have to serve them well and then wait until they're ready to upgrade or replace equipment. The key is having a clear strategy for converting that installed base.

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