Was This Acquisition Made for All the Wrong Reasons?

Description

On Tuesday, Montréal-based **Transcontinental Inc.** (TSX:TCL.A) reported earnings for the first quarter of 2013. While revenues sunk 5%, earnings were flat on an adjusted basis, and the company raised its dividend by 10%. The shares now yield just over 4%.

But the headline-grabbing news was an announcement that the company agreed to acquire Capri Packaging, an American printed flexible packaging manufacturer, for U.S. $133 million. The deal size is of no small significance to Transcontinental, representing more than 10% of the company's market capitalization.

Transcontinental is stepping into uncharted waters to an extent – flexible packaging is a business the company is not currently involved with. But Transcontinental sees a natural fit with Capri's operations, since the production process is very similar to Transcontinental's traditional printing business.

Transcontinental CEO François Olivier is very excited about the new business line. In a statement, he said "This acquisition represents an important strategic move for the Corporation into a new promising growth area. It is part of our strategy to ensure our future growth path through diversification."

Dubious circumstances

Transcontinental is Canada's largest printer, making money from magazines, books, flyers, and newspapers. It is also the largest door-to-door distributor of printed advertising in Canada, printing flyers for companies such as **Loblaw Companies** (TSX:L) and **Canadian Tire** (TSX:CTC.A). In recent years Transcontinental has come under pressure from digital competition, contributing to revenue declines like the one announced Tuesday.

Transcontinental seems to be making the acquisition in an effort to reignite growth, and Mr. Olivier's comments support that claim. As he put it, "Printing is not a growth business and media is a transformation business. Packaging for food is evolving, but there's no such thing as a digital transformation and there's growth every year."

Transcontinental also seems to be paying a high price for Capri. The $133 million purchase price gives

Transcontinental two plants with a total of $72 million in annual revenue. The 1.85x price-revenue multiple seems high; by comparison, Transcontinental trades at 0.8 times revenue.

Foolish bottom line

Acquisitions should never be made just for growth's sake, and so far it appears that's what Transcontinental did. It also appears that Transcontinental paid a premium price for a company in a new industry. If Transcontinental did this transaction just to offset declining revenue in its traditional business lines, then the company likely destroyed shareholder value.

It's little wonder that Transcontinental's shares are down more than 2% on the day. And despite the cheaper stock price, investors are likely better off staying on the sidelines.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:TCL.A (Transcontinental Inc.)

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