THE PROACTION GROUP LLC

Identifying Operational Opportunities to impact EBITDA, Market Position and Free Cash Flow in Due Diligence

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While attending a recent event, a person asked me what do I do for my clients.

As an operational consultant, it is often hard to clearly and succinctly describe our role.

One way I have come to help paint a picture is to share that we spend some of our time helping our clients access and leverage low cost country resources, and we spend most of our time helping US companies compete with low cost country competitors.

We help them increase the output of their plants, reduce the cost of shipping products, reduce the cycle time to turn around orders, increase inventory turns; we help them fulfill customer demand at the lowest cost and in the shortest time.

Our process begins with an assessment of the company.

In that assessment we develop a business case for the executive team to take action on root cause issues that impede their EBITDA earnings, position in the market, and balance sheet health. We identify the signals that they have opportunities to improve, quantify the impact in financial terms, and then build a clear set of plans, budgets, risk mitigations, and timelines to implement the envisioned future.

In short, we give the CEO and the executive team the information they need to take prudent action.

Private Equity firms can use this same process to build a clear, actionable, and practical understanding of the opportunities to go beyond management plans when deciding to acquire a company, and how much it can bid in the process.

In the upcoming series of articles that I will be writing for M&A Chicago, we will focus on identifying the potential value hidden in operations, whether during the pre-close due diligence phase, or during the hold phase

We will explore:

- The indicators of opportunity. What can you look for in an operation that will signal if an opportunity justifies additional investigation?
- Methods to quantify the opportunity
- Common approaches to address the opportunity

We could look at hundreds of specific opportunities in each functional area of a business. To provide structure, we will aggregate opportunities along the lines of 7 Value Levers that we use to organize our thinking. These value levers include the following:

Value Lever	Definition	Example Results
Throughput	Increase the actionable output of a plant, service location, supply chain or other facility.	• 20% to 100% increase in throughput with no increase in staffing or equipment • Reduction in lead times, increased flexibility
Variable Costs	Reduce the expense directly related to the volume of products or services provided. Examples might include overtime, the cost of raw materials or ingredients, temporary labor, inventory write offs, outside services and freight.	• Reduce the cost of purchased goods and freight. Results can range from 0% to 40% depending on the commodity and existing agreements • Reduced overtime, labor, scrap, rework and warranty costs
Fixed Costs	Reduce the cost of assets and expenses that do not change, in the short term, based on customer demand. Examples might include the costs of facilities, base labor (not including temporaries or overtime), equipment, long term leases, IT systems, and G&A costs.	• Reduce labor costs (beyond overtime and temporary labor) • Consolidate Facilities / reduce floor space required • Access / leverage low cost country resources
Order to Cash Cycle	From the moment we buy raw materials, we have capital committed to a customer order, and that capital is not returned until the customer payment is received and deposited. By focusing on the order to cash cycle, we mine the opportunities to minimize the company's exposure and cost of capital.	• Speed up collections (especially for health care clients) • Increase speed to market in new product development processes • Reduce raw material and component inventory levels
Pricing	High performing companies design pricing strategies in the executive suite and they are executed as designed in the field. We also find, however, that many companies lack the controls to enforce compliance in reality. Often, we find that the base pricing strategies and their realization in the field can be improved.	• 1-3% increase in revenue (all going to EBITDA) • Effective price increase execution and control (i.e., pricing strategy designed in the board room gets executed in the field)
Asset Utilization	A company leverages its assets to create and fulfill customer demand. In this section we look at the use of facilities, fleets, raw materials, inventory, A/R, suppliers, warehouses, IT systems and other assets. Often we find ways to receive a better return on each of the types of assets directed by the company.	• Increase inventory and A/R turns • Increase overhead absorption / capacity utilization of existing plants, facilities and equipment
Risk Reduction	Much like a home inspector in a real estate transaction, we need to evaluate the basic ability of the company to maintain current results and to, at a minimum, realize management's plans. As much as direct EBITDA reductions, minimizing and mitigating risk adds value to the organization.	• Manage commodity pricing risks • Reduce risk of excess and obsolete inventory

In our next article we will focus on evaluating opportunities in a company related to throughput! Here are two recent examples of findings in due diligences related to throughput and the impact realized within the first year of owning the company:

- A seafood company landed Costco and Sam's Club as a customer within months of each other. They were running their plant 24 / 7 and could not keep up. They needed to add 40% more capacity or risk losing one or both customers. They did not want to build a new plant. Not only would that drain significant capital, but they would become dependent on customers that often change their product offering. In a two day assessment we identified a path to increase throughput with existing equipment and staff by 50% in 60 days. Two months later, they eliminated their backlog and still serve both customers with their same plant and setup.
- A packaging company also operating 24 / 7, showed signs of incongruous production scheduling and demand planning processes. Within 6 months of acquiring the company, throughput was up 20%, inventory levels were down, and product margins all increased by 5-7%. There was no capex attached to this improvement.

In our next article we will share the methods we use to identify these opportunities during a normal due diligence process! The questions we ask. The analysis we complete. The indicators we look for during plant tours. The reports we review. Stay tuned!

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If you have any questions or requests, please feel free to contact me at tvm@proactiongroup.com.