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Wealth Management.

Mitigating risk and identifying potential

A case study for operational and commercial due diligence success



Presenters



Dave Plomin, Partner

Dave is a partner in Plante Moran's Management Consulting Strategy and Operations practice. He advises organizations on their most complex and critical issues and is known for his ability to dramatically improve business performance. Dave focuses on operational due diligence, performance management, restructuring, and carve outs. His clients include private equity groups and manufacturing and distribution organizations seeking to further improve their competitive position in the marketplace, increase profitability, or prepare for increased growth and scale.



Tim Erdmann, Principal

Tim is a principal in Plante Moran's Management Consulting Strategy and Operations practice. He advises organizations on the development and implementation of manufacturing and operational strategies and tactics, instituting advanced cost management systems, redesigning workflows and value streams, and developing and leveraging high-performance teams to drive operational and financial performance. As a former Chief Operating Officer, Tim has a blend of operational and financial expertise that enables him to identify improvement strategies and tactics that result in viable cost savings and margin improvements.



About Plante Moran

Plante Moran is among the nation's largest certified public accounting and consulting firms.

1924

Year founded

50+

Years providing consulting services to improve organizations

2,200+

Professionals

20,000+

Clients

900+

Private equity and portfolio clients

23

Locations



Overview of today's discussion

- Project approach
- Deal background
- Findings and results
- Takeaway



Polling question 1

Do you consistently perform operational due diligence with each deal you're involved in?

- Yes
- No



Three project objectives



1

Analyze
current performance



✓ Assessment scorecard



2

Identify
EBITDA potential



✓ Three year financial projection



3

Prioritize
integration efforts



✓ Implementation plan
✓ Capex estimates
✓ Risk mitigation plan



Polling question 2

What percentage of deals do you perform full operational due diligence with the same priority as financial due diligence?

- Less than 20%
- 20% to 40%
- 40% to 75%
- More than 75%



Common engagement challenges



Speed versus thoroughness:

- Need to get in and out of locations fast
- Collect information once without a lot back and forth



Seller cooperation:

- Slow to provide data
- Restricts access to site and people



The deal

Closely held, custom equipment manufacturer was looking to sell

- Second- and third-generation owners involved in the business
- Owners sought to sell approximately five years ago but did not receive an acceptable offer
- Spent the last five years creating value
- Large, multidivisional manufacturer interested in buying

OPERATIONS

50,000 square foot facility+
outside warehouse

150 employees working
one shift per day

<\$100 million revenue

Manufacturing areas:

- Metal cutting and forming
- Welding
- Assembly
- Paint
- Inspection and functional test



Deal drivers

Provided a strategic advantage for two of the buyer's divisions:

1 Division that supplies parts to the target company

- Protected existing significant business that potentially could have been lost
- Aligns with buyer's vertical integration strategy

2 Division that competes against target company

- Seller had strong brand name in market
- Certain features of the seller's equipment were known as best-in-class
- Expands the buyer's marketplace reach (adds new customers)



Buyer's concerns

	FINANCIAL				COMPETITIVE		
	Revenue	Cost	Balance sheet	Cash flow	Customer	Competition	Growth
Seller was late on key deliveries to customers	✓	✓			✓		✓
Stated production cycle times were much longer than industry standard		✓	✓				
Certain cost structure components were significantly higher than expected	✓	✓					
Target has lost money the past few years	✓	✓	✓	✓	✓	✓	✓
Buyer concerned that transaction would affect their own employees' focus on their critical tasks		✓		✓			



Current performance



Key findings

- During the data review, interviews, and plant walkthrough, three main areas emerged as critical drivers to current performance:



Leadership effectiveness



Performance management



Manufacturing efficiency

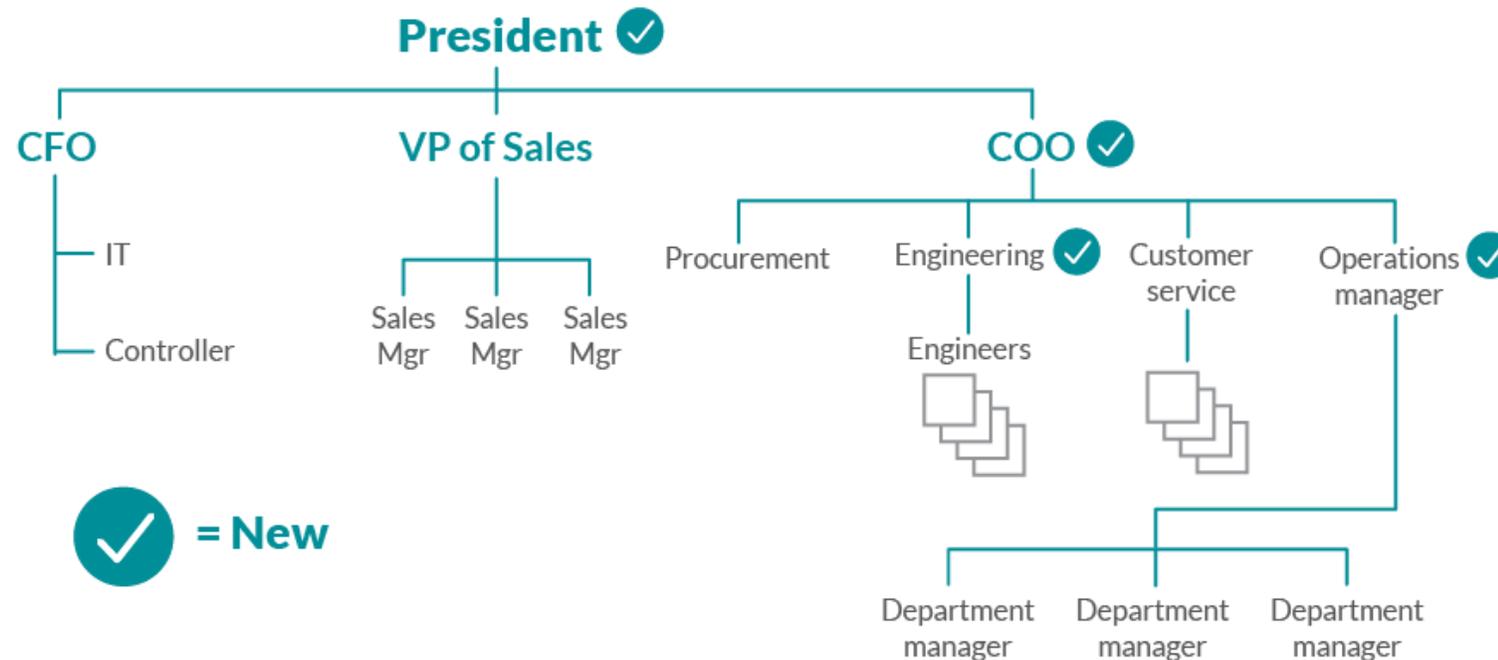


Current performance



Leadership observations

- New leaders have been hired to fill key positions to introduce modern production techniques and train key operations staff on Lean Manufacturing disciplines





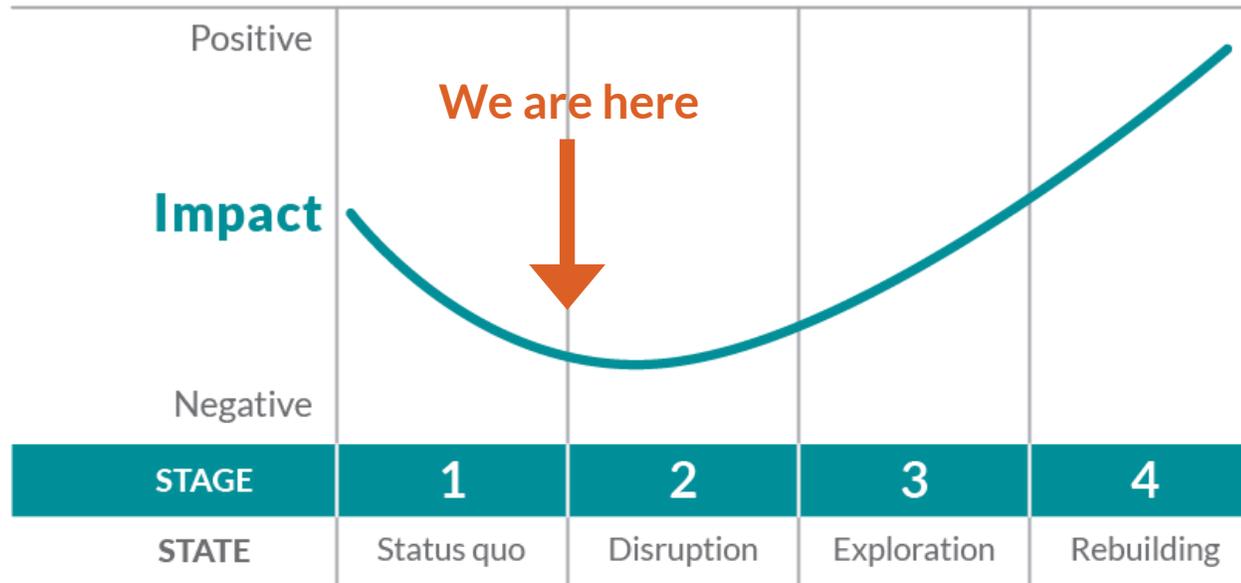
Current performance



Leadership observations

- Noteworthy improvements have been made in the last three years with significant work still to be done

The Change Curve





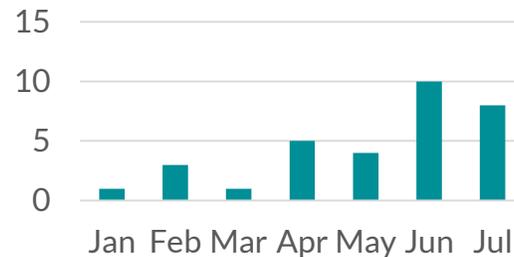
Current performance



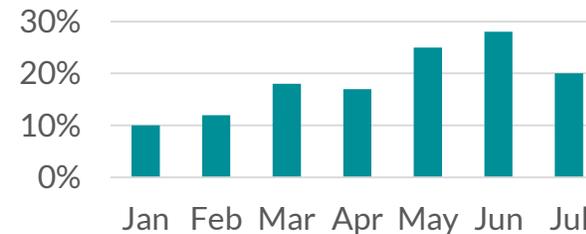
Performance management observations

- Some of the track metrics indicated unhealthy trends that were corroborated during plant walkthroughs

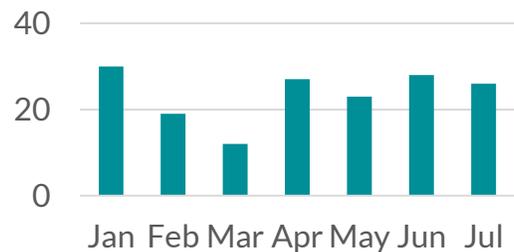
Safety



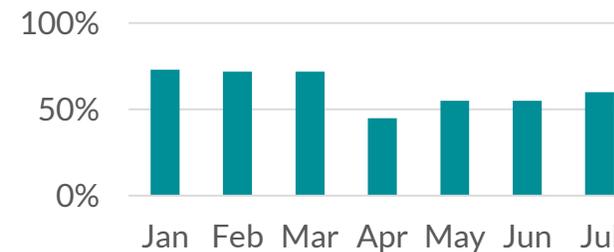
Scrap rate



Quality



On-time delivery





Current performance



Performance management observations

- Many tracked metrics provide limited value in communicating the status of the business. Metrics that would be useful to manage the business:



Schedule attainment



Parts produced per hour (per operation)



Downtime (planned and unplanned)



Capacity & demand per department

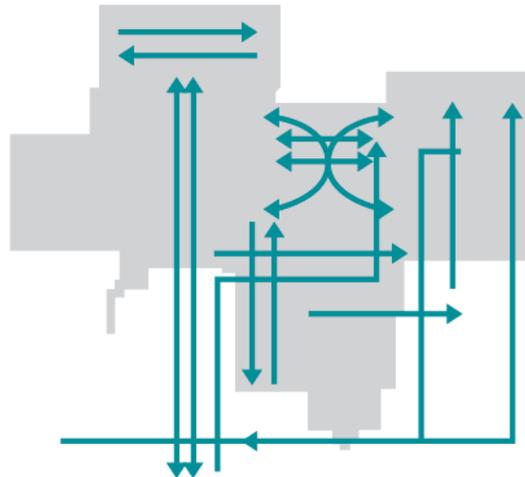


Current performance

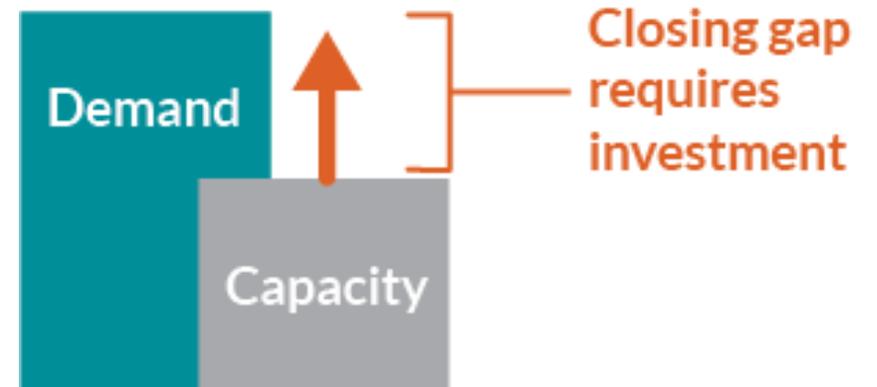


Manufacturing observations

- Production flow through the facility resulted in partially built equipment traveling back and forth and in and out of the facility multiple times as they were being made



- Current layout capped production capacity at a level below future sales projections. Capital expenditures and layout/process flow changes would be required in order to increase production capacity





Current performance



Manufacturing observations

- Work space cleanliness and organization has been a lower priority for the new leadership to address



Production delays



Safety hazards



Quality defects

- The Final Assembly operation was recently converted from a static manufacturing in 17 bays to a continuous flow operation. This area is a model of flow and organization for the rest of the operation





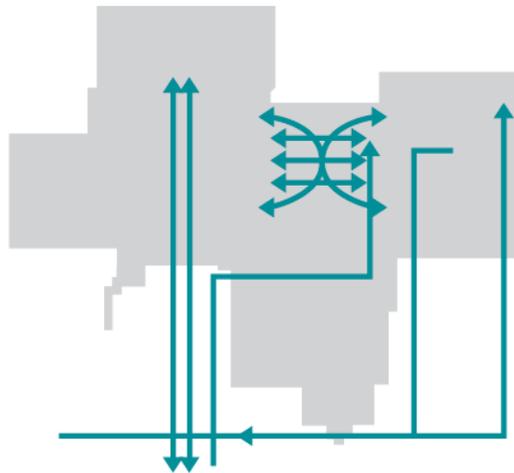
EBITDA improvements



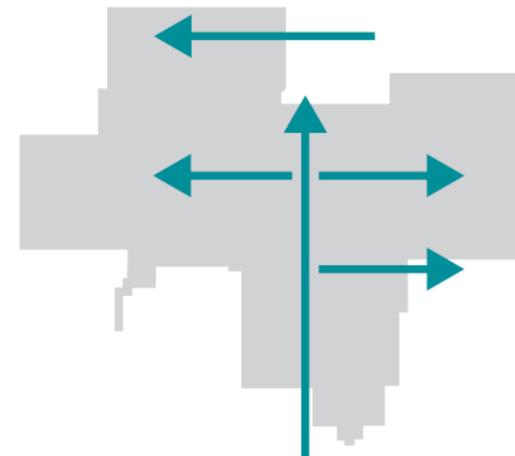
Directional recommendations

- As a result of the current performance review, key areas for improvement were identified:
 - Increase capacity to meet customer demands
 - Improve product flow to synchronize subcomponent manufacturing and improve quality results
 - Provide better visibility to current production status
- Building off improvements made in the Final Assembly area, additional changes were recommended in the other production areas

Current product flow



Potential product flow





EBITDA improvements



Directional costs and benefits

Plante Moran developed directional capital expense cost estimates:

Paint material handling \$1.0-1.5M

Assembly & welding automation \$6.0-7.5M

Machining upgrades \$1.5-2.0M

3PL savings:

One time: Inventory reduction \$2.0-3.0M

Ongoing: COGS reduction \$0.5-0.75M

Anticipated benefits:

Increase capacity by 50%

Reduce lead times

350-400 days

<200 days

Generate savings of \$4.5-6.0M
with a 23-month ROI



EBITDA improvements



Integration benefits

- A realignment of similar products manufactured in the buyer and target facilities would further reduce capacity constraints and provide space for significant future growth
- 3PL integration would further reduce buyer's logistics and inventory management costs



Prioritized integration plans



Draft working schedule

Months	1	2	3	4	5	6	7	8	9	10	11	12
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PROJECT MANAGEMENT

- Perform detailed analysis
- Create implementation plan
- Project manage plan execution



PAINT MATERIAL HANDLING

- Vendor identification and quoting
- Vendor selection and build
- Plant installation



WELDING AUTOMATION

- Vendor identification and quoting
- Vendor selection and build
- Plant installation



3PL INTEGRATION

- Vendor identification and quoting
- Vendor selection and build
- Vendor migration





Conclusion

1 Analyze
current performance

2 Identify
EBITDA potential

3 Prioritize
integration efforts



- Higher ROI,
- Risk mitigation,
- Be more impactful with tangible output



Polling question 3

Going forward, what percentage of deals do you intend to perform full operational due diligence?

- Less than 20%
- 20% to 40%
- 40% to 75%
- More than 75%



A final takeaway

Hidden value and risks can be found along any component of the operations scorecard

Operations Scorecard	Management Systems	Strategic Alignment	Innovation
		Continuous Improvement	Quality Systems
		Organization Design	Employee Engagement
	Production Model	Workforce Integration	Order Fulfillment
		Safety / 5S	Productivity
		Lean Flow	Manufacturing Flexibility
	Support Services	Sales Effectiveness	Technology Systems
		Back Office Effectiveness	Inventory Management
		Sales & Operations Planning	Costing



Q&A



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