CASE STUDY

Competitive Business Solutions

Due Diligence Process Identifies Incremental Costs

Competitive Business Solutions (CBS) was retained by one of its private equity partners to conduct operational due diligence of a commercial glass processor. This target was a part of a much larger conglomerate and was being split off or "carved out" to form a separate operating company. CBS focused its industry expertise on operational and IT diligence and ultimately helped develop the model for the stand-alone organization.

INDUSTRY
Commercial Manufacturing

SOLUTION AREA
Acquisitions & Integrations

"CBS's ability to field a team of experts in short order and analyze the opportunity is amazing."

— Managing Partner, PE

THE CHALLENGE

As with most private equity acquisitions, once senior leadership becomes aware that the business is for sale, time emerges as a crucial element. The seller becomes reluctant to invest time and resources into the business, and the buyer wants to complete the deal to minimize risk of the deal falling apart or key resources leaving the organization. Acutely aware of time in this circumstance, CBS immediately mobilized a team of experts who were versed in the industry, operations and informational technology (IT) expertise and who understood the unique challenges of sizing, staffing and "carving out" a standalone organization.

THE APPROACH

In any undertaking it is important to understand what the desired result is. At CBS, when we engage with our client partners, it is no different. The diligence process starts with a discussion with the client to clearly understand the premise or deal thesis supporting the acquisition. This provides a clear understanding of the buyer's vision on creating value after acquisition, the concerns they have and the areas they would like further exploration. These inputs go into CBS's diagnostic approach and allow for a targeted diligence plan.

Understanding what the company's data reveals is imperative in completing a meaningful analysis. In this case, CBS spent time reviewing the data provided prior to arriving on site. This is an important part of the diligence process and is often overlooked. CBS approaches diligence as if we are an extension of the private equity company because, in fact, we are. Having a clear understanding of the data provided and being able to ask meaningful questions during limited executive meetings is critical. This focuses the questions on understanding versus information-gathering, and it demonstrates to the target company that we are prepared. This prepared approach builds instant creditability and alerts the team that we know what we are doing and often improves the quality of the information provided by the seller.

In this diligence, the company was part of a larger conglomerate and was being sold as a standalone company. An integral part of this analysis was to understand the future overall cost structure as well as where the second production facility should be located. As with most sales, the current management team provided guidance on what they believed was appropriate for the business. They provided an overhead structure going forward that was well thought out and, on its surface, quite believable. Additionally, it presented a scenario where the buying company purchased two of the existing buildings to manufacture in the future.

After reviewing the production facilities and information provided, CBS began the process of developing an alternative scenario where the private equity firm purchased the main operational site (current operations headquarters) and would lease / buy a facility close to the current operations headquarters, allowing for the sharing of critical resources. CBS modeled the various options and identified an incremental $2.5 million in one-time costs and $.9 million for recurring costs over what management had presented. This information was able to be used in the final price negotiation. Providing these details for the private equity company significantly reduced the purchase price.

CBS not only identified the increases in costs, but as a result of our dive into operational performance, we identified an incremental $2.8 million in annualized savings or approximately 3% of annual sales. The savings were identified in both productivity improvements and material scrap reduction.

Through supporting in the building location, sizing, layout and start of production, CBS continued to assist the private equity firm and its new company after the deal was finalized.

$3.4 million incremental one-time and recurring cost identification and $2.8 million in performance improvement

STATISTICAL RESULTS

	Management Projection of Incremental Costs for Carve-Out	CBS Projection of Incremental Costs for Carve-Out	Δ Delta
One-Time Costs for Stand-Alone			
Relocation (Infrastructure and Move)	$300,000	$1,500,000	$1,200,000
Recruiting Costs for New Business	$0	$500,000	$500,000
Training Costs for NewCo	$100,000	$225,000	$125,000
D&O Tail Policy	$0	$100,000	$100,000
Business Disruption	$0	$225,000	$225,000
IT Carve-out Costs	$15,000	$400,000	$385,000
Total One-Time Cost	**$445,000**	**$2,950,000**	**$2,535,000**
Stand-Alone Recurring Savings / Costs			
Overhead Salary Reductions	$0	($500,000)	($500,000)
Hourly Rate Impact	$0	$200,000	$200,000
Transportation Savings	$0	($175,000)	($175,000)
Facility Lease cost	$240,000	$700,000	$460,000
Insurance Expenses	$0	$900,000	$900,000
Corporate Stand-Alone Costs	$1,260,000	$1,275,000	$15,000
Total Recurring Costs	**$1,500,000**	**$2,400,000**	**$900,000**
Estimated Savings from Future Process Improvement Activities			
Scrap Reduction	$60,000	$400,000	$340,000
Productivity Improvements	$700,000	$2,400,000	$1,700,000
Total Savings	**$760,000**	**$2,800,000**	**$2,040,000**

Numbers revised to protect confidentiality

CONCLUSION

Utilizing a systematic approach, CBS was able to quickly and efficiently analyze and validate the worthiness of the private equities acquisition. In addition, to simply validating it, CBS identified approximately $3 million in one-time and recurring costs not previously identified by the selling company. Furthermore, we determined an annualized savings in scrap reduction and productivity improvements of $2.8 million. This cost identification helped the private equity company negotiate a more favorable deal, and the savings potential can help mitigate some of the risk of the acquisition.

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