GUEST ARTICLE

Applying Turnaround Techniques To Healthy Companies

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During any turnaround strategy, immediate, decisive action is needed to stop the bleeding and quickly position a company for recovery. While such time-of-the-essence action isn't usually required for the leveraged buyout of a profitable company, many LBOs can benefit from the techniques implemented by turnaround professionals to assess and correct the operations of distressed companies.

This article outlines some of these turnaround techniques, and how buyout professionals can utilize them to quickly improve the operations of their portfolio companies.

13-Week Cashflow

Few traditional buyout firms utilize a 13-week cashflow analysis at the outset of a deal since the company usually starts out with significant excess availability. The firm may also wish not to appear too controlling with its management partners at the outset of a buyout. However, preparing and maintaining a 13-week cashflow analysis at least for the first few months of a new investment can be a healthy and enlightening exercise. It does not replace traditional monthly projections (12-24 months) or three to five year annual projections, but rather supplements those analyses.

A 13-week cashflow is very different from traditional monthly projections that are calculated on an accrual-based accounting methodology. A 13-week cashflow is a cash-basis analysis utilizing the company's working capital revolver as its cash source. It focuses on the key inputs to the change in the revolver balance such as shipments, cash receipts, disbursements (raw materials, overhead and G&A), payroll, ineligible A/R and ineligible inventory, etc.

In a turnaround, the 13-week cashflow is the focal point for managing under tight availability circumstances. A turnaround professional must examine each lever point in the 13-week cashflow to find ways to enhance cashflow. This often includes increasing receivable collections, cutting payroll and disbursements, reducing inventory safety stock and decreasing ineligible A/R and inventory.

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This heavy focus on maximizing cashflow can also help the management team of a healthy company to better understand the key triggers in their business. One of the key benefits of a 13-week cashflow analysis is that it provides a lot of clarity into how cash is generated in the business. It can lead to much better working capital management practices and improve decision-making in areas such as credit and collections, procurement and G&A spending.

Customer Profitability

Both distressed investors and turnaround consultants focus on an accurate study of customer profitability. In a distressed company, often one or more customers or customer segments are not profitable or marginally profitable. Since it is critical to stop the bleeding as quickly as possible, finding unprofitable or marginally profitable customers is a high priority in turnaround situations.

With LBOs, customer profitability should also be a key element of due diligence because it helps to identify the company's most valuable customers, segments for growth and segments to exit or customers to drop.

"True" customer profitability reporting, however, is a rare commodity. Long ago I stopped being shocked by how few middle-market companies could produce a "true" customer profitability report to the contribution margin level. When asked, most management teams will proudly pull out a gross profit by customer report as their profitability report. However, gross profit by customer often distorts the true profitability picture for a company because of additional customer-specific costs that fall below the gross profit calculation.

A "true" customer profitability report will take into account other expenses specific to a customer such as returns and sales allowances, slotting fees, commissions paid to sales people, outbound freight costs, dating terms on A/R, promotional expenses and personnel.

In one extreme example, I built a customer profitability report for a distressed candy distribution company several years ago. One customer represented over 40 percent of sales and at the gross profit line it appeared to be decently profitable. However, this large mass-market customer was notorious for returning product or demanding "end of season" discounts to move their remaining inventory, which can dramatically affect true profitability. After we took into account "end of season" discount credits, co-op advertising, initial slotting fees paid and volume rebates, this customer's "true" contribution margin was less than 3 percent.

Oftentimes management is surprised by the results of a contribution margin level profitability study. Some customers move down

and others move up in importance as a result of the study.

Lean Assessment

At Getzler Henrich, we utilize lean assessments on most of our engagements because it can often lead to quick cashflow improvements from the operational side of the business. Getzler Henrich's approach to lean is to identify and reduce the waste (any process that does not improve the form or function of product or service) within any process of the company's operations. Lean initiatives are used on the manufacturing floor as well as with service businesses, health care fields and within administrative back-office operations.

While a full lean implementation can take many months, Getzler Henrich subdivides any lean implementation into several one-week Kaizan events. A Kaizan event involves mapping a process, brainstorming improvements with employees, implementing changes and measuring the results of the changes. By breaking down operations into smaller processes that can be improved in one-week intervals, our approach to lean is variable: A company can implement as many of the one-week Kaizan events that it would like. It allows a company to get sustainable results fast and to see early results before committing to further implementations.

In one example, Getzler Henrich implemented a three-week lean program at a division of a company that fabricated and welded aluminum boxes. The project involved reconfiguring the manufacturing floor to create two parallel one-piece flow lines. Common parts could be utilized by both lines, thereby reducing work-in-process inventory and material handlers could service both lines more efficiently. The three-week project resulted in a dramatic 55 percent reduction in work-in-process inventory, 29 percent decrease in per box costs (primarily labor), 98 percent reduction in cycle times from 2.5 days to 24 minutes, and a 60 percent reduction in total floor space. These types of quick improvements can lead to dramatic improvements in cashflow to help a distressed company survive.

While lean can have a dramatic impact on distressed and under-performing companies, there are usually many lean savings opportunities in well-managed companies. More importantly, if implemented correctly lean creates a framework for continuous improvement that is initiated by the company's own workforce. This culture of continuous improvement becomes the biggest benefit of lean over the long-term.

Procurement Study

Detailed procurement studies also can yield large savings opportunities for traditional buyouts. I have seen procurement savings across several categories range from 10 percent to 30 percent of purchase as a result of a detailed study. Internal personnel can also conduct these procurement studies but often the process benefits from an outside perspective.

Private equity groups also have the added opportunity to aggregate purchasing for certain commodities, such as communications services, employee benefits, insurance and possibly even raw materials (steel, paper, packaging) across several portfolio companies. Experienced consulting firms can help establish these aggregated buying programs and develop processes for dealing with the addition of new companies or the exit of existing companies from purchasing portfolio groups.

Sales And Marketing

A key element of any successful turnaround is a detailed analysis of the company's core competency and the development of a strategic and tactical plan focused on that competency. Rarely is a company's distress related only to outside factors. In most turnaround situations, management or former management have made a series of decisions that have led the company down the path toward distress. Oftentimes, those decisions related to moving away from the company's core competency or competing on price without regard to the "value proposition" of its products or services. A turnaround manager must quickly assess the situation and develop a tactical plan to correct the company's strategic direction.

In a recent example, Getzler Henrich's sales and marketing team helped a regional household paper client refocus its business around its core competency. The client was a low-cost producer of high-quality environmentally friendly paper products. However, former management was focused on competing on price and promotion instead of its "value proposition." Based on market analysis, Getzler Henrich determined that the market was demanding a mid-range to premium price product for an environmentally friendly brand. Additionally, Getzler Henrich determined that several of the company's key customers were unprofitable because of heavy promotion and allowance spending that the company had initiated and increased over the years.

Getzler Henrich developed and implemented a strategic and tactical plan to reposition the brand as "environmentally friendly," increase price and eliminate much of the non-beneficial promotional spending. The plan led to double-digit revenue growth and returned the company to profitability after a number of years of losing money. The company has been able to continue to grow because of its repositioned focus on "green" marketing.

While traditional buyouts are firmly profitable, a detailed analysis of the company's core competency and its sales and marketing practices can yield valuable insights and profit enhancement opportunities. A good assessment can find opportunities for improved pricing, new markets/products, increased revenue from existing customers and better overall sales and marketing structures.

Getzler Henrich's professionals bring expertise in cash management, customer profitability, lean, procurement, and sales and marketing optimization. However, analysis alone does not deliver results. We also bring years of experience in managing the boardroom politics and employee turmoil that inevitably results from such transformative events as a bankruptcy or LBO. Careful management of competing interest groups and employee morale is vital to delivering exceptional returns. This combination of experience with specific turnaround techniques can be the key to a successful LBO in today's troubled market. ❖

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