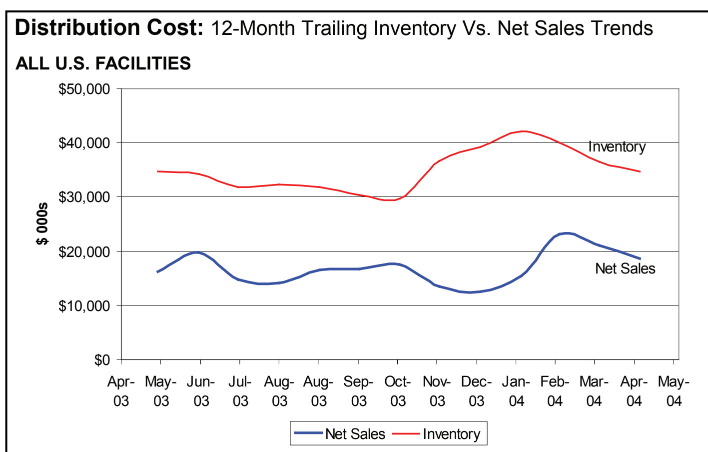
Operational Due Diligence At Add-On Sporting Goods Company:
Positioning The PE Firm For An Auction Win By Identifying Standalone And Synergistic Cost Savings Opportunities

The Challenge: As part of the execution of a buy-and-build strategy, a private equity firm had targeted a $200MM acquisition, SafetyCo, which manufactures and distributes a product similar to a company already in the portfolio. In order to bid most competitively in the auction situation, the private equity firm needed to find the maximum operational savings opportunity. Due to pressures of the mass distribution channel (their primary customers), the previous private equity owner had already captured many of the first-round opportunities typical to mid-market companies. For instance, much of the labor-intensive manufacturing previously performed in the U.S. had been moved to low-labor cost countries, and warehouses and other facilities had been consolidated. Gotham was brought in to perform a rapid but robust operational due diligence so that the prospective buyer could understand the next-generation savings opportunity and, thus, bid most competitively in what was an auction situation.

The Partnership:
Analysis: The 2-week operational due diligence began with an analysis of high-level data available in the on-line data room, including facility location and headcount information; some supplier contracts; monthly and annual P&L, balance sheet and cash flow statements; capital expenditure details and plans; distribution channel information; product profitability and unit analyses; and management presentations.

To further understand SafetyCo's operations, we visited their manufacturing operations to capture first-hand observations and interviewed SafetyCo senior executives (COO, CIO, VP of operations, VP of Asian sourcing, etc.) to discover their views on further potential cost-saving areas.



To estimate the value of operations opportunities, we first disassembled aggregate financial information for each supply chain by creating a profile of product lines and mapping the product flow. We then estimated revenue and cost of goods sold by developing a cost model for material, labor, overhead, outbound freight, and inventory:

- Material costs were estimated using material cost benchmarks from the existing portfolio company and similar operations, and applying various triangulation points, e.g., units cost information, supplier agreements (regarding volumes)
- Labor costs were built up from detailed headcounts by location and benchmark wage information
- Variable overhead was calculated using a benchmark factor multiplied by direct labor costs for similar products manufactured in the same approximate geography
- Freight was calculated using the geographic distribution of the customer base, similar benchmark information, and existing freight rates
- Inventory turns were estimated using available financial data and benchmarked against similar businesses.

We also gathered cost information from the prospective bidder's similar portfolio company to identify synergies and to benchmark current and pro-forma spending.

Strategy: We reviewed early information with the deal team and agreed to focus the opportunity assessment on four areas: distribution costs, sourcing opportunities, infrastructure costs (including SG&A, IT), and working capital. For each area, prospective savings opportunities were identified and described, and savings were benchmarked against efforts at other companies. Finally, we created separate savings estimates for two alternative scenarios--acquiring SafetyCo as a standalone company and combining SafetyCo with the related portfolio company.

The Results: The private equity firm issued multiple bids in the auction process, and was successful in the acquisition of SafetyCo. Post-merger integration work has begun in earnest.

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