

Operational Due Diligence Of Global Tier 2 Automotive Components Supplier: Finding And Valuing Cost Reduction Opportunities

The Challenge: JumboCo (a publicly traded conglomerate) had altered its business strategy to focus on its core industries, and as a result, had decided to divest 4 non-core divisions. One of Gotham's long-time PE clients had entered into an exclusivity arrangement to purchase these divisions, which included AutoInc, a leading Tier 2 designer and manufacturer of advanced automotive components with manufacturing facilities in US, Mexico, Europe, and Asia. AutoInc's own business strategy revolved around expanding its presence in the high-growth Asian market and establishing a strong manufacturing base in low-cost countries. The PE client asked Gotham to assess AutoInc's operations and identify cost reduction opportunities.

The Partnership:

Analysis: The Gotham team began by reviewing the financial and operational data available in the data room to quickly develop a top-level profile of AutoInc. We then shared this profile and our initial findings with the deal team and agreed that the due diligence investigation should focus on:

- The potential for and value of automation and short-term cost reduction opportunities at AutoInc's US operations
- The potential for greater leveraging of the low-cost Asia supply base in the longer-term
- The cost and capacity implications of potential longer-term network optimization.

Along with the deal team, the Gotham team conducted a 2-day site visit to the U.S. facility to hear the management presentation and get a first-hand view of day-to-day operations. While on site, the team also interviewed members of management (including the CEO, CFO, and VP Engineering and Customer Service) to gain their perspectives on strategy and operations.

We then conducted detailed analyses to fill in data gaps and supplement our first-hand findings:

- **U.S. Facility** – Performed rigorous analysis of the U.S. facility cost structure to construct a fact base that included:
 - Detailed cost profiling of labor (direct and indirect), material, overhead (salaries and expenses) and general & administrative costs
 - The current state of line automation
 - Line capacity utilization at current and projected volumes.
- **Network** – Uncovered the relative cost positioning of AutoInc's global manufacturing base and network configuration, with our fact base including:
 - A top-down analysis of AutoInc's cost structure, broken down by region
 - Detailed analysis of AutoInc's product portfolio and product profitability and cost competitiveness by manufacturing region
 - Mapping of the company's current network configuration
 - Profiling of the cost and capacity implications of future network configuration options based on bottom-up modeling.

Findings: We identified \$33-46MM in potential cost reduction opportunities (\$24-37MM beyond what was called for in the management plan):

- A \$4-7MM near-term cost reduction opportunity in the U.S. operations from:
 - Bringing direct labor efficiency up from 70% to 80-85% via increased focus on line discipline, line balancing to reduce idle time in work centers before and after bottleneck operations, and downtime reductions from preventive maintenance
 - Reducing scrap by 15-25%, especially in the automated lines
 - Reducing overtime premiums (currently at 12% of direct and variable indirect costs) by 40-60% by resolving equipment downtime issues, improving throughput via better line balancing, etc.
 - Reducing manufacturing overhead by 10-20% and negotiating with union for better terms on fringe benefits
 - Better managing MRO purchases (potential 5-10% cost savings)
- A \$6-14MM material cost reduction opportunity (\$2MM quickly) by greater leveraging of the low-cost supply base in Asia and developing alternative suppliers to diversify the supplier base
- A \$23-25MM longer-term savings from network optimization:
 - Closing the European facility
 - Migrating production of labor-intensive products from the U.S. facility to low-cost locations
 - Expanding Asia joint venture to supply all Asian product needs.

