

Operational Due Diligence Of Customized Consumer Products Company: Validating Management's Operations Plan And Identifying Additional Savings

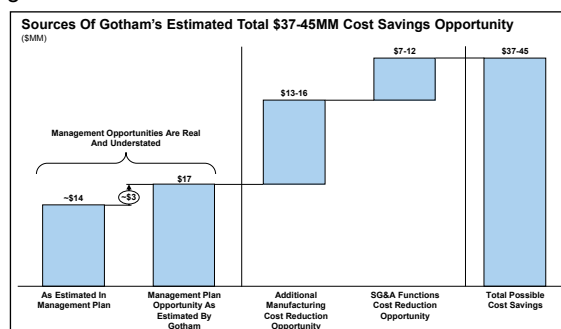
The Challenge: Gotham's client, a large PE firm, was in a hotly contested auction of a \$1+B customized consumer products manufacturer. The target had high margins but was facing growth challenges due to changing consumer preferences. Consequently, the target's management had built significant cost savings into its plan to offset a potentially flat/declining revenue outlook. Given the target's complex, multi-division structure (multiple sales forces, 11 manufacturing plants), our client asked Gotham to conduct a 2-week operational due diligence to validate management's cost reduction plan and identify additional cost reduction opportunities to provide our client an edge in the auction.

Operations Improvement Plan Validation And Opportunity Identification/Quantification: Access to the target's management, plants, and data was very limited due to the nature of the auction. To overcome this, Gotham supplemented what financial and some operational data was available in the dataroom with a visit to 1 of the target's plants. Combined with our extensive experience in similar manufacturing operations, we were able to build a solid fact base of the target's cost structure, including a detailed 4-year line-item-level view of the operational cost structure by division, plant, department, labor function, expense type, etc. using monthly trial balance data. We also analyzed the target's 2,000 employee workforce, linking each individual to a specific cost line in the target's cost structure. In performing a fact-based analysis of cost reduction opportunities, we:

- Developed a comprehensive outsourcing/consolidation model based on our line-item-level cost structure and individual-level headcount analysis. This model considered seasonality, run/order size, the impact of recent CapEx, and transportation, material, and direct labor costs, enabling Gotham to rapidly and reliably test different cost-saving scenarios for each division.
- Analyzed sales, marketing, customer service, and G&A cost opportunities using our organizational structure analysis, competitive benchmarks, and an assessment of cost savings enabled by outsourcing/consolidation.

\$6.5-7.5MM EBITDA Improvement Opportunity Beyond Management Plan In Precious Metal Division

Leveraging our experience in precious metal product manufacturing, we confirmed the viability of management's plan of outsourcing 1 product category to Mexico and closing 1 plant. Analyzing unit cost by manufacturing step, Gotham established that cost savings were in fact 20-40% higher than the management's estimates. We also assessed the remaining product categories and concluded that the target could outsource most remaining precious metal goods production to Mexico, allowing it to downsize the remaining plant to a small work cell for products requiring domestic production, generating \$5+MM in additional savings.



Management's Plan To Close 3 Out Of 4 Plants In The Printing Division Validated

Gotham conducted a zero-based analysis to validate management's cost reduction plan, which called for outsourcing the majority of the printing division's volume and consolidating 4 plants into 1. We analyzed the target's order profile to identify orders that would be more economical to outsource and estimated the resultant order profile in the remaining plant. We then established the cost structure for the remaining production volume taking into account plate-making, make-ready, printing, and finishing costs and identified post-consolidation efficiency gains from higher utilization, longer run sizes, reduced seasonality, and new capital investments. Gotham investigated the possibility of closing the remaining plant as well, but concluded that the risk mitigation/flexibility value of retaining the plant outweighed the marginal savings from closing it, particularly given the magnitude of cost savings we had already identified beyond management plan.

\$7.5-9.5MM EBITDA Improvement Opportunity In Apparel Division, Not Considered In Management Plan

Although management was not planning for any cost reduction in the apparel division, we thought it worthwhile to assess the viability of outsourcing the target's apparel and accessory product lines to Central America or Asia. We concluded that many suppliers possess the capability of producing these product lines and can meet the target's requirements of customization and fast turnaround. Leveraging our comprehensive outsourcing/consolidation model, Gotham estimated a \$7.5-9.5MM cost reduction opportunity from closing the target's 2 apparel plants. We also developed a phased plan to close the plants and move rental/distribution activities to an empty building in another division.

Incremental SG&A Headcount Reduction Represents A \$7-12MM EBITDA Improvement Opportunity

Gotham also assessed the target's sales, marketing, customer service, and G&A (finance, IT, HR, and administrative) functions to identify additional cost reduction opportunities beyond outsourcing/plant consolidation. Our analysis of the target's complicated sales organization – multiple sales forces comprising internal sales staff and 3rd party representative and serving different end-markets and business units – leveraged industry benchmarks and our cost structure and headcount fact base, and identified/quantified an opportunity to de-layer target's sales management structure and increase the size of sales territories to reduce sales headcount without affecting performance. We also identified an opportunity to reduce marketing costs by pooling spend from different divisions and quantified G&A savings enabled by the organization's network simplification (9 plant closures and 30-40% headcount reduction). Finally, Gotham identified an opportunity to consolidate customer service groups following plant closures and to potentially outsource routine customer service functions.

The Outcome: Gotham identified \$37-45MM in fact-based cost savings, 2-3x management's savings plan, giving our client an edge to win the auction. After the purchase agreement was signed, management validated our findings, agreed with our recommendations, and started planning for implementation.