# Operational Due Diligence Of Entrepreneurial Specialty Engineering Services Firm: Instilling Process Discipline Required For Future Growth

The Challenge: Our client, an operationally oriented PE firm, was in advanced negotiations with a specialty engineering services firm offering a diverse range of highly technical consulting services focused on building safety. Through an aggressive strategy of opening new offices and acquiring competitors, the target's entrepreneurial-minded management had transitioned the company from a regional firm servicing government contracts to a global company with 22 offices. While impressed by the growth, our client was uncertain about whether the target's processes were sufficiently robust to scale the company up to the next level, and was concerned about the lack of revenue forecasting model. To establish confidence in the target's operational capabilities, our client asked Gotham to conduct a 3-week operational due diligence focused on assessing the firm's prospect-to-cash cycle processes.

Prospect-To-Cash Cycle Process Assessment: To quickly build a solid fact base of the company's operations, the Gotham team conducted a 3-day visit to the target's headquarters and 1-day visit to a branch location, supplemented by phone interviews with multiple branch managers, to: (1) gain management perspective on the company's operations and improvement opportunities; (2) map the company's processes front-to-back; (3) collect financial and operational reports beyond those available in the data room; and (4) gain access to operational data from the company's ERP system and offline databases. Gotham's on-the-ground, fact-based approach enabled us to uncover valuable offline cost and project inquiry databases being utilized by front-line personnel to track operational performance and to gain insights into company operations not previously known to the senior management.

Uneven Performance Across The Company Offers A Sizable EBITDA Improvement Opportunity

To overcome the target's operational and cost reporting shortfalls, Gotham built a robust profile of the target's revenue, cost, margin, and labor utilization by office, project type, customer type, and employee. To accomplish this, Gotham dissected and reallocated the company's financial and project data, as well as triangulated and analyzed information from multiple data sources (data room, ERP, offline databases, and management interviews). Having created this robust fact base, Gotham discovered that the company's profitability was driven by only a few projects and customers, with a substantial portion of revenue driven by unprofitable projects. End-market operating margins varied substantially, with one end-market generating 1/4th of the total revenue and producing substantially higher operating margin than the others. Branch performance also varied greatly within and across geographies, with operating margins ranging from 5% to 50%, indicating an opportunity to improve EBITDA if all branches started performing at the level of higher profitability branches.

Cost And Operating Income By Office ($MM, % Of Total)
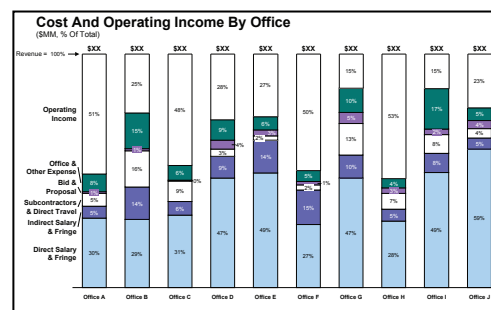
Best Practices Adoption Across All Branches Would Lead To Process Discipline Necessary To Ensure Profitable Growth

Gotham's process assessment of the company's prospect-to-cash cycle established a clear picture of the actual processes followed by the front-line personnel and the process variations among the company's branches. Our effort identified key process gaps and best practices to set the stage for the company's operational improvement effort, including:

- **Marketing/Business Development:** While historically the target's marketing and business development processes were ad-hoc, management had begun steps to build a marketing infrastructure. Gotham established a need to create explicit growth strategies by end-market that capture differences among end-markets; we created a framework to aid management in this process. On the business development side, we established an approach to leverage best practices across branches, and highlighted the need to implement and leverage a formal customer relationship management and lead/proposal tracking system.
- **Revenue Generation:** While the proposal creation processes were somewhat formalized, processes varied by branch and pricing estimates typically relied on experience with no formal pricing tools in place. Project execution/management processes were not formalized and there was no reporting to track progress against plan. Billing and collection process discipline had improved over the last 2 years but had poor time and expense tracking and late accounts receivable collection. To support the next level of growth, a standardized and formalized approach to all revenue generation processes would be required.
- **People Management:** Gotham established that the company's culture is performance-oriented and very supportive around that performance. However, performance management was reactive and driven by top-down reviews. Gotham recommended establishing organization-wide performance reporting to create visibility.

Revenue Forecasting Feasible Through Triangulation Of Multiple Approaches

While the company lacked a forecasting process, Gotham found that senior engineers kept in constant communication with clients to obtain visibility on level of activity and select offices used leading economic indicators to gauge current/future levels of activity. We recommended a forecasting process that triangulates from multiple approaches (e.g., timed backlog, market size trends, historic sales data, and lead/proposal tracking) and is segmented based on project size, type, and customer.

The Outcome: Gotham provided our PE client with an explicit top-level operations end-vision and value creation plan, enabling confidence about the target's ability to support growth and, hence, the value of the deal. The company management, post-acquisition, with the support a board member (an ex-CEO of an engineering services consulting company brought in by the PE firm), leveraged Gotham's fact base and value creation plan to improve the company's operations.