

Profitability Diagnostic At Promotional Mattress Manufacturer: Establishing True Cost Picture And Identifying Operations Improvement Opportunities

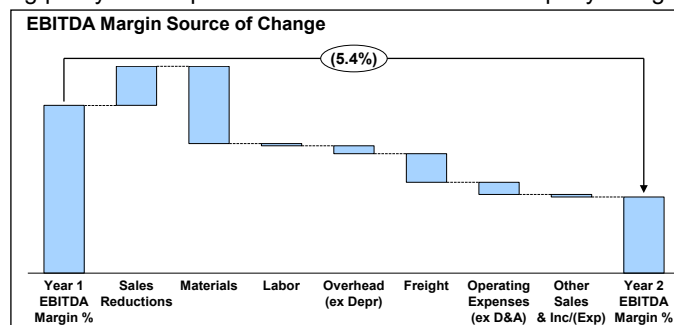
The Challenge: A portfolio company of one of our PE clients was one of the largest promotional mattress manufacturers in the U.S., with a nationwide multi-plant network. The company had experienced significant growth in EBITDA over the past few years, followed by a measurable decline in revenue and profit despite the company increasing prices. There was a lack of clarity about what was driving the profitability decline, the true cost picture, and whether the company was losing customers versus an industry-wide decline in sales. As such, Gotham was asked by our PE client to dissect the company's cost structure, understand drivers of profitability decline, and identify operations improvement opportunities.

Dissection Of Revenue And Cost Structure: Gotham undertook a rigorous data-driven approach to analyze the company's operations and identify key drivers of profitability decline, including:

- Building a true cost picture by analyzing and reconciling multiple large and disparate data sets, including sales data, plant-level trial balances, invoiced order/shipments, and internal facility metrics:
 - » Allocated sales reductions to each individual invoice line by analyzing cash discounts, rebates & allowances, returns, and customer contracts
 - » Established true product cost by reconciling material, labor, and overhead cost data at the invoice level with monthly plant-level trial balances, and applying variances at the invoice level
 - » Established freight cost at the product, plant, and customer level by triangulating shipment details from individual invoices, truck cost from transportation providers, and routing data from the supply chain management platform, and developing a truck cost allocation model to distribute the cost of a truck to all delivery stops on the truck
- Performing customer profitability analysis by developing customer segmentation (national, regional, and mom & pop retailers) and profiling profitability across customer segments and products
- Analyzing customer churn in order to profile profitability across lost, retained, and new customers and the overall impact of each customer segment on the company's recent profitability decline
- Developing an Excel-based analytics platform for the company to update in order to gain a recurring view of true cost and profitability and to serve as the foundation for its new PowerBI dashboard which was in development.

Significant Increase In Freight Cost Driven By Increase In Oil Prices And Decline In Truck Utilization

Although on surface, freight cost did not appear to be an issue, Gotham established that the true impact of freight cost increase was far greater, driven by an increase in cost per mile along with an increase in miles traveled due to inefficient routing practices. While the company shipped more orders on each truck as compared to previous years, it was not enough to offset freight price increase and routing inefficiencies. The company's freight pricing policy also impacted its bottom line as the company charged uniform freight to all customers despite actual freight cost being a function of customer distance from the plant. Furthermore, inefficient use of the company's dedicated fleet resulted in greater use of common carriers and higher fixed costs per order due to the significant fixed costs associated with dedicated trucks. Through our freight cost analysis, Gotham identified opportunities to optimize logistics operations in 3 areas: a customer acquisition approach based on increasing route density with targeted sales focus; a higher order size minimum in less dense areas to improve truck utilization; and flexible delivery schedules and wider delivery windows to optimize route efficiency.



Profitability Impacted Severely By Increases In Product Cost Due To Non-standardized Operations Across Plants

The company's material, labor, and overhead costs had increased significantly both in absolute terms and as a % of sales. While the company had increased prices to pass on material cost increases to the customer, the profit margin still declined as material costs made up a larger share of costs and decline in volume adversely affected labor efficiencies and overhead costs. Gotham's operations assessment identified inconsistencies in labor costs across plants, limited sharing of best practices, and non-standardized processes for changeover, labor planning, plant flow, and material handling. Gotham developed a future operations vision that focused on 3 key opportunity areas: (1) rebalancing production by developing a hub-spoke plant network configuration, with hub plants carrying a full range of production capabilities and spokes closer to customers with only limited capabilities and a lower overhead cost structure; (2) standardizing best practices and deploying tracking tools, scorecard/goal boards, and KPIs across plants to better track productivity and wastage; and (3) reducing SKU complexity by modularizing and standardizing product design, and postponing differentiation to the last possible manufacturing step.

The Company Was Losing Its Most Profitable Customers, Leading To Both Volume Decline And Margin Contraction

Gotham established that mom & pop customers accounted for ~50% of the revenue and the company had lost a sizeable proportion of its smaller and more profitable mom & pop customers. Larger customers were growing fast, but these large customers were not as profitable due to high cash rebates. In addition, volumes for retained accounts had declined and new customer sales had not been sufficient to replace sales associated with lost customers, leading to a decline in both top line and profitability.

The Outcome: Gotham's robust analysis of the company's cost structure and identification of operations improvement opportunities provided our PE client with clear insights into the true cost picture and the drivers of profitability and sales decline at its portfolio company. Gotham also provided a tool for recurring monthly updates on profitability and cost, informing the design of the company's PowerBI system and enabling the launch of a focused operations improvement effort.