

CASE STUDY

International Industrial Contract Manufacturing Company

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The Case

Two 50/50 owners of a fast-growing second-generation family business want to exit in three to five years. The current valuation of the company, based on industry benchmarked EBITDA multiples is \$12-14 million, but the current risk profile of the company makes it an unlikely candidate for sale to a third-party on favorable terms. The target exit value, after-tax, is \$30 million. Our challenge is to triple enterprise value within five years while dramatically increasing the probability of transfer. The owners agree to consider both external and internal transition options.

Fact Pattern

- The company is owned equally by two brothers
- \$50 million annual revenue
- 150 employees
- CAGR of approximately 10% year over year
- Consistently profitable
- Despite COVID-19, 2020 was their most profitable year since founding in 1992
- The owners expressed a strong preference for exiting the company within five years
- The estimate of value at the beginning of the project was \$12-14 million, based on a benchmarked multiple of EBITDA. The target exit valuation is \$30 million, after-tax.



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The Path to Value Maturity

The five stages of value maturity are: identify, defend, accelerate, harvest and manage.

Discovery is the first step in identifying value drivers and killers. Although our client faced many challenges, comprehensive Discovery surfaced fundamentals that provided a “scaffolding” for successful value acceleration. Without those fundamentals, we would not be able to build a program to double enterprise value and increase transferability within five years.

Interviews with the owners and key employees revealed a host of value acceleration opportunities, but there were substantial headwinds, including:

- Managing exceptions instead of catching people doing something right to develop best practices
- A culture of silence
- Failure to confront challenges as a team
- Disrespect for authority
- Slow decision-making, especially on the things that mattered the most
- Poor hiring practices at all levels and very little talent development/training
- Muddled compensation practices, sometimes rewarding bad actors
- Poor risk identification and management
- An outdated business and revenue model, moving toward commodification
- Quickly abandoned product and service innovations
- Disagreements about the company’s value proposition
- No coherent strategy or plan – and less agility than competitors
- Undermanaged sales processes and team
- Confusing sales enablement and marketing
- No defined niche or readily identifiable competitive advantages
- Outmoded technology, lacking IT management
- Random capital investments with no clear ROI expectations
- Inconsistently utilized operational and financial key performance metrics
- No cadence of regular management meetings
- Material gaps in leadership skills



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Discovery also revealed exciting value acceleration opportunities (we call them tailwinds):

- A genuine willingness to and desire for change
- Consistent revenue growth and growth-minded ownership
- Industry topping gross and net margins
- Great client relationships and a high degree of loyalty
- Client diversity
- Geographic coverage
- Efficient procurement
- A low project failure rate
- Excellent financial controls and conservative financial management
- Strong bankability
- A healthy balance sheet with enough working capital to weather difficult times
- Unexplored growth markets with good fit for current services and products
- Industry leading customer support

Designing and Implementing a Value Acceleration Solution

Following Discovery, we initiated structured programs to transform from a culture of silence and inconsistent leadership to a culture of value creation. We used RFN's 90-day Decision Dynamics sprint to give everyone in the company the competencies they needed to figure out what matters together, make better decisions faster and manage with grace and accountability. More than 150 employees participated in the program over a three-month period.

Because the company's core enterprise process was unclear to some – or there were different versions of it – we mapped the process of how they turn opportunity into money. As a result, all employees now understand where they and their team fit in the process, what comes before and after, and how they can enable success.

Next, we built a platform focused on managing five types of risk: strategic, operational, financial, reputational and regulatory. The company now has designated risk managers who collaborate to identify, prioritize, mitigate and monitor value killers.

Because the enterprise process had been mapped, we could locate areas of potential waste or lower than desired productivity. We used Value Stream Mapping to evaluate



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key processes and make them more efficient. This became a key driver of higher profit during COVID-19.

The company lacked a strategic vision and plan that aligned with shareholder expectations. We helped them create a one-year plan with three 90-day strategic initiatives to answer the two strategy questions: “Where are we going?” and “How will we get there?” This process is ongoing and will be reviewed bi-annually to ensure agility.

Throughout this process, to shore up leadership and help them to “show up” differently to employees, we partnered them with certified leadership coaches who are part of the RFN extended enterprise. They have been working together for two years, individually and in groups.

Finally, we worked with them to revamp their financial strategy, so it is fully aligned with their strategic and operational planning, keeping efficient use of working capital at the forefront, and building a dynamic forward-looking financial model to help with forecasting and cash flow management.

Outcomes

Although revenues were slightly lower in 2020 compared to 2019, net profit doubled to the highest margin in the company’s 28-year history.

Culture and risk management have vastly improved which will drive a higher multiple at the time of sale (lower risk being the primary driver of higher multiples).

For the first time, the company has a compelling strategy, an evolving business model and new revenue streams across diversified markets.

The finance department now understands capital priorities, including the importance of managing shareholder returns. Despite COVID-19, the shareholders took their largest distribution ever in 2020 without threatening company liquidity needed for future growth.

The managing owner/CEO, as well as the executive team, can now forecast cash flow accurately for up to six months, enabling better strategic decisions and financial transparency.

To govern shareholder returns, there is now a distribution policy in place.



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Valuation Impacts

The company's estimate of enterprise value when we started implementation was \$12-14 million, based on a relatively low multiple due to its substantial risk profile. However, we did not believe the business was transferable to another owner at that time.

The value acceleration initiatives have increased net profit and lowered risk, while diversifying and opening new opportunities with higher margins. The estimate of value is now \$19 million, and its acquisition attractiveness factor has increased substantially. We feel confident the target exit value of \$30 million is within reach as our work continues over the next two to three years.

The cost of the value acceleration program has been \$162,000, so far. We expect the client will spend approximately \$350,000 (not including legal, accounting and insurance expenses) when the program is complete. Upon exit at the target threshold of \$30 million, the shareholders' after-tax Return-on-Investment for value acceleration will be approximately 46x.

Wealth Advisors Play a Key Role

We were referred to the owners by their wealth advisors. As they developed financial plans and wealth strategies for the owners, it became clear that each of the two would require net proceeds from their exit to be higher than the current value of the company. When they receive the proceeds, how their shares are held (i.e., within a trust or as individuals) would also influence the planning. Throughout the engagement, we have been in frequent contact with the wealth advisors to update them on progress. We have also collaborated to develop sophisticated strategies that lower financial risk for the owners through more aggressive distributions, very low-cost borrowing, tax-deferred investments and life insurance.