

ARTICLE

Private Equity: Uncover Hidden Value and Mitigate Operational Risks Faster

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Key Takeaways:

- Higher deal multiples and increased risk make it essential to fully understand the operational risks and opportunities with the greatest impact on value creation.
- The five most critical areas for operational due diligence in today's manufacturing market are daily management, sourcing and inventory, site leadership, talent, and CapEx/automation.
- Speed, quality, and horsepower are keys to identifying and mitigating risk, finding and prioritising hidden value creation opportunities, and setting the stage for rapid realisation of deal potential post close.

The right focus, skills, and expertise enable PE firms to quickly hone-in on critical operational opportunities and rapidly identify and mitigate risks that can make or break the investment thesis.

Ops Due Diligence Hot Spots: What Matters Most in a Hyper-charged Environment

Higher multiples, increased risks, and newly exposed issues that were not on the radar prior to the pandemic are making predicting top line value creation more volatile. And that makes good due diligence essential. Windows for this process remain compressed, but you can make every minute count when you know where to look.

5 Focus Areas for Quickly Identifying and Mitigating Risk

[The operational due diligence areas](#) that have become most critical (and most vulnerable) to top line value creation in manufacturing are:

1. Daily Management Practises
2. Sourcing and Inventory Strategies
3. Site Leadership Capabilities
4. Labour Availability and Best Practises
5. CapEx/Automation

Right now, these areas are home to the most red flags as well as the most untapped value. Having the expertise and horsepower to put boots on the ground and validate full potential analysis quickly, without slowing down the deal flow, ensures a better bid, and a better plan for rapid value creation.

1. Daily Management Practises

Ideally, you want to see signs of aligned activity between the top floor and shop floor, so that what happens daily in operations supports the company's overall objectives and financial performance. Good daily management practises are also a must for empowering problem-solving and sustaining gains long-term.

What to look for during pre-LOI

- Gemba walks
- Visual management tools and systems
- Workplace organisation
- Standard work implementation



What to analyse during LOI

- Pareto of misses
- Quantified improvement opportunities
- Operational leadership skills of management team and supporting stakeholders

We have seen many PE firms quickly embed a comprehensive lean-based management system, establish standard work, and launch improvements that move the needle fast, leading to sustainable performance improvements of 15% or more with half of the near-term potential often realised in the first six months.

2. Sourcing and Inventory Strategies

Critical component and product shortages continue to challenge S&OP processes while rising material and labour costs are increasing the need to rethink supply strategies and give serious consideration to in-sourcing or near-shoring. Gaining a solid understanding of network optimisation capabilities, supplier performance, lead times, working capital position, quality, and costs is critical to estimating true potential.

What to look for during pre-LOI

- Level of WIP, finished goods, and obsolete or excess inventory
- Component shortages
- Shuttered lines or other production roadblocks
- Use of MRP systems



What to analyse during LOI

- Inventory turns
- Scheduling and demand planning processes and capabilities
- Sourcing strategies including longer-term cost reduction opportunities
- Supplier risk
- Customer segmentation and profitability

Much can be done in the first 100 days, including demand planning and SKU rationalisation, to put more efficient supply chain and S&OP practises in place. Bigger strategic sourcing changes take time, but even these changes can be fast-tracked.

3. Site Leadership Capabilities

Given the rough stretch most operational leaders have endured, it is essential to know what you are getting—a battle-weary team, or leaders who are ready to embrace change, drive aggressive growth, and engage the team.

What to look for during pre-LOI

- Executive team makeup and gaps
- High level executive skills including technical capability and leadership
- Engagement levels
- Performance-driven culture
- Site conditions including workplace organisation and safety



What to analyse during LOI

- Understand / assess organisational change readiness
- Flight risks
- Tiered accountability structure and audit processes
- Problem solving methodologies
- KPIs and if the company is using them to drive behavioural change

You can address leadership behaviour immediately with coaching and mentoring, management system discipline, and leader standard work. Strategic embedded resources can also be put in place quickly to help accelerate needed change.

4. Labour Availability and Best Practises

Recruitment, turnover, and training have historically been challenges for manufacturers and the pandemic has exacerbated the issue to the crisis-level for some, putting production schedules in jeopardy. Understanding a target company's current talent situation can help uncover root causes as well as what can be done to rapidly improve the talent situation.

What to look for during pre-LOI

- Labour availability and how it impacts the production schedule
- Number of open requisitions
- Time to fill open requisitions
- Employee turnover rates



What to analyse during LOI

- Recruiting, hiring, and onboarding approach
- Resource pool
- Competitor hiring practises
- Training programmes

We helped one PE-owned manufacturer reduce open positions from 19 to 1 and reduce turnover from 40% to 12% in less than three months. The multi-tiered approach included pay increases, adjusted hiring criteria, and a partnership with a local technical programme.

5. CapEx/Automation

Automation is key to delivering on promises and sustaining profitable growth, especially with manpower in short supply. If a target company has meaningful equipment and facility capacity to spare, then automation should be on the table, specifically where it reduces the need for people performing non-value-added work. Of course, the company also needs the capex to support investments.

What to look for during pre-LOI

- Asset condition
- Use of automation vs. manual labour
- Use of IIoT
- Maintenance team activities including PM discipline and safety observations



What to analyse during LOI

- Capital plans directed toward facility upkeep and new technology adoption
- Ability to identify needs and prioritise technologies that address critical issues such as labour shortages
- Technology vetting and implementation practises

We recently assisted a PE-backed potato processing plant in capturing \$1.6 million in savings on its production and packing lines by introducing automation to eliminate monotonous material handling and packaging work. By creating processes for prioritising, vetting, and implementing automation, we accelerated both implementation and payback.

The Mechanics Haven't Changed. But The Need for Sharper Focus In Key Areas Has

Getting the true potential of a deal right has never been more important. Or more challenging. Observing and analysing the right areas, with a focus on speed and quality, ensures you have the insight you need to identify and verify the value, address the red flags, and create the roadmap that will drive rapid value creation, ultimately setting the stage for a successful exit.

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Meet the Experts



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