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Smart M&A

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BIGGER NUMBERS

John Tilson and Matt Sondag
discuss the value creation process

Matt Sondag
of West Monroe
Partners

John Tilson of Brown
Gibbons Lang & Co.

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BIGGER NUMBERS

Building blocks to maximizing enterprise value

By Danielle Toth

Whether a middle market business has a short- or long-term horizon as it prepares for a potential sale, the value creation process can bring increased profits in the near term and a higher exit multiple when it eventually does come time to sell.

John Tilson, managing director at Brown Gibbons Lang & Co., says the investment banking firm often meets with business owners early into their strategic planning process.

“It helps us identify areas of improvement, ultimately making for a better sale,” he says. “However, we often will meet with business owners who believe their businesses are ready to sell but aren’t. A significant amount of diligence and coordination goes into the successful sale of a business.”

Treating enterprise value creation as a strategic process can enable a business to:

- Improve operations and systems to increase profitability
- Improve information reporting, which will give potential buyers and lenders greater confidence in financial projections
- Support a higher level of competition among potential buyers
- Reduce closing risk by mitigating potential red flags

PARTNERS AT THE START

The typical sale process begins with a review of a company’s business model; management and operations, including information systems; financial performance; and competitive landscape. BGL conducts a SWOT analysis (strengths, weaknesses, opportunities, and threats) and through this thorough evaluation, is able to assess the marketability of a business and potential risks that could arise during a sale process, Tilson says.

While this analysis is performed for any business readying to sell, the enterprise value creation process is a logical next step for those businesses that have a longer time horizon. To assist in that process, BGL often teams up with leading operations and IT consulting firm, West Monroe Partners.

“We’re trying to help our clients think strategically about their business, and we want to educate them before it’s too late,” Tilson says. “It’s actually pretty unique for investment bankers to be partnering with a consulting firm, which we believe offers significant value to middle market business owners.”



A major driver of value is information systems, says BGL's John Tilson (left) and Matt Sondag of West Monroe Partners

POST M&A ENTERPRISE VALUE CREATION

Embracing enterprise value creation doesn't stop with a sale, as DentaQuest learned with the acquisition of Doral Dental USA, the nation's top administrator of government dental programs.

DentaQuest knew that operating on different business models supported by two disparate IT platforms could hinder its ability to grow its people and their organization. It acknowledged the need for change and sought guidance from West Monroe Partners in helping build an integrated strategy to support its mission, "to improve oral health for all."

As a result, DentaQuest proactively reshaped its IT strategy into a comprehensive business transformation initiative. This innovative approach would ultimately result in the replacement of the two business units' separate operating processes and underlying legacy claims systems with a single enterprise business model and standardized technology platform.

"Over the course of the next several years, we partnered with DentaQuest to execute this strategy by establishing a comprehensive end-to-end solution that optimizes their business processes and maximizes their technology investment," explains Kristin Irving, head of Dental Strategy and Solutions at West Monroe Partners.

Today, DentaQuest's new operating environment and technology platform serves more than 14 million members and provides widespread benefits in productivity, accuracy, and self-service capabilities. It is realizing substantial savings just months after implementation due to increased auto-adjudication, workflow automation, as well as more accurate claims processing.

"Perhaps most significantly, this transformation effort better positions DentaQuest for future growth and acquisitions with its new scalable business model, technology platform, and successful methods for post-merger integration," comments Will Hinde, director and Healthcare Payer Practice lead at West Monroe Partners.

The post-acquisition enterprise value creation success is evident. DentaQuest has improved its market position, moving up from the No. 5 to the No. 3 dental insurer in the country, and continues to make great strides towards their vision of becoming the preeminent oral health enterprise in the nation.

West Monroe Partners, which also works with private equity investors in the middle market, is well-versed when it comes to evaluating businesses to identify ways to increase value. Matt Sondag, director and head of M&A at West Monroe Partners, explains, "BGL builds relationships with middle market companies and provides strategic insight and guidance sometimes years before a sale. We become involved to offer strategy and implementation experience for both operations and IT to increase enterprise value."

LEVERAGING INFORMATION SYSTEMS TO DRIVE VALUE

While many factors weigh in preparing for a sale, a major focus is on information systems.

"Many mid-market companies don't have robust systems," Tilson says, "which dictates the quality of information being used to manage the business. Buyers are not willing to pay as much for a business that lacks the necessary tools to measure and monitor performance."

Companies too often rely on disparate IT systems making it difficult to consolidate and analyze data, which can lead to a delay in reporting. A company might take up to 45 days to complete its monthly financial statements—a process that should typically require only seven days with the proper information systems. That time can be problematic for any business but particularly for one trying to finalize a deal. "It leads to a lot of uncertainty with the buyer and can drive down the seller's valuation," Tilson says.

Some companies are reticent to make the necessary investment because they don't readily see a bottom-line impact. Sondag says a new or upgraded information system can bring tremendous value to a company.

"Information systems give organizations key data that helps them better measure and manage their business," he says. "We've worked with companies that had no visibility regarding its product gross margins, specific to each customer. That type of data is absolutely critical to understanding product and customer profitability, in order to answer simple questions like 'who are our most profitable customers?' or 'what are our highest and lowest margin products at Customer XZY?' Regardless of your business type, we implement reporting solutions that give our clients the ability to gather and interpret operational and sales data to improve decision making."



OTHER VALUE DRIVERS

Information systems are a major driver in building enterprise value, but there are additional ways to extract value from a business.

Reviewing operational processes can identify weaknesses in the chain of communication across business lines to prevent delays in critical decision-making.

The supply chain is another area to unlock value. West Monroe uses best practices and benchmarking data to analyze a company's supply chain management practices and identify areas for improvement.

Sondag offers the example of a leading fashion and home décor business. After 16 years in operation, the company turned to West Monroe to identify ways to improve its critical business processes, distribution operations, and order processing. Once the initiatives are fully implemented, the company is expected to realize \$13 million in cost savings from increased production efficiencies and improved productivity. "It's critical the technical infrastructure is in place to enable the business processes to be effective and efficient, while enhancing the customer experience. We live in a world where our customers are becoming more and more sophisticated and hungry for data. The IT systems must be able to respond to the external customer, in addition to serving the business (internal customer)," Sondag says.

PLANNING FOR THE FUTURE

"Business owners with a longer term horizon can really benefit from the enterprise value creation process," Tilson says. "In addition to identifying ways to improve efficiency and curb costs, the knowledge gained may identify new products or markets to exploit, all with the goal to enhance return on investment."

Sondag agrees. Enterprise value creation is simply smart business. "It allows a company to create new revenue streams, streamline its operations, and strengthen its relationships or 'stickiness' with its customers," he says.

"That's something any business owner should want to do, whether a sale is being considered or not." ■

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TALE OF TWO TRANSACTIONS

Without Enterprise Value Creation

A global manufacturer of modular systems employed sales agents in more than 60 countries, and its ability to penetrate the growing international market was unmatched. The company was projecting revenues to reach \$44 million, a 20 percent increase year over year, and EBITDA of \$9 million, a 43 percent year over year increase. It elected to pursue a sale without first undertaking the enterprise value creation process.

CHALLENGES - UNRESOLVED

- Lack of integrated information systems
- Significant engineering expense without associated revenue growth
- Long delivery times
- Overabundance of SKUs
- No direct sales effort for add-on products (reliance on large orders from limited number of customers)
- Exposure to foreign currency translation risk

RESULTS

Indications of interest were received from six prospective buyers with an initial value range of \$35 million to \$55 million. Further due diligence identified these issues, which resulted in only two interested parties and a substantial reduction in value, with indications ranging from \$30 million to \$35 million. The remaining buyers ultimately walked away from the deal because of softness in the company's sales pipeline and backlog.

MISSED OPPORTUNITIES

If the company had taken time to navigate the enterprise value creation process, it could have:

- Implemented an integrated ERP and CRM system, which would have:
 - Saved an estimated \$2 million in duplicative operating expenses
 - Improved the quality and timeliness of operational and financial reporting
 - Identified profitable SKUs and eliminated others
- Reengineered operational process flow for improved delivery times
- Updated price lists more frequently to adjust for major foreign currency fluctuations
- Focused on add-on sales by incenting dealers and developing a direct sales strategy
- Implemented an ROI-based product development system

With Enterprise Value Creation

A U.S.-based and family-owned national electrical products distributor with \$400 million in sales approached BGL about exploring a potential sale of the business. BGL recommended postponing the sale and put forth an enterprise value creation roadmap to maximize value.

CHALLENGES - RESOLVED

- Replaced several members of the management team and instituted new corporate culture
- Established standard company-wide pricing controls
- Established improved incentive compensation system for sales force
- Implemented efficiency projects to reduce cost structure and streamline operations:
 - Upgrading branch distribution network by identifying and closing unprofitable branches
 - Migrating to a more efficient clustered hub-and-spoke distribution system
- Centralized purchasing, maximized rebate, discount opportunities within supplier network
- Instituted processes to improve workforce productivity to establish margin levels on accounts and identify unprofitable customers

RESULTS

Within the first six months following the initiative, the company's sales increased by 14 percent and EBITDA grew by 22 percent. Twelve months later when the company was sold, EBITDA had increased two-fold, and the purchase price multiple realized for the business was one of the highest ever paid for an independent distributor of electrical products.