



SUPPLY CHAIN  EDGE

# Generating Greater Return on Investment for Private Equity Firms



**Supply Chain Edge  
Operations Due Diligence  
and Performance  
Improvement Assessment**

In the wake of one of the most severe and widespread financial crises in history, business conditions for private equity (PE) firms are quite different from those of “pre-Lehman.” Long gone are the days in which PE firms could readily turn to banks to finance investments based on high multiples of EBITDA, generous rate structures and loose financial covenants. It is clear that the availability of funds and borrowing terms from banks will be more stringent for years to come and equity requirements will remain high.

Adding to the pressure on PE firms are the many deals initiated within the past few years that will have term loans coming due in this very different financing climate. Restructuring these investments will be challenging given the fact that the companies purchased are, in many cases, experiencing free cash flows significantly lower than when purchased. Thus, it is critical for PE holdings to take steps to improve their operational performance.

## How Supply Chain Edge Can Help

Achieving operational excellence requires a deep understanding of leading manufacturing and supply chain practices. It also takes an ability to quickly assess current operations, identify and prioritize improvement opportunities and implement methods for sustainable performance improvement—all of which leads to greater EBITDA. This is a far different “on the ground” expertise than what is typically found in the financial acumen of most private equity partners. That’s where Supply Chain Edge can help. Our advisors are veteran supply chain professionals with decades of experience working “in the trenches” at companies across industries. This experience enables us to work with PE firms to not only conduct due diligence on acquisition targets’ operations to gain a realistic picture of the targets’ present state and potential, but also to identify and enact changes in existing portfolio companies’ supply chains that dramatically improve these organizations’ financial performance.

### *Conducting Rigorous Operations Due Diligence*

Supply Chain Edge brings deep operational expertise and a proven assessment process to the due diligence investigation of a target acquisition. Supply Chain Edge quickly mobilizes to conduct an in-depth review of a target acquisition’s key operations, inventory, and financial information, including the following:

### **Operations**

- Operating review meeting notes (past 12 months)
- Improvement projects – status and contribution
- Distribution work standards performance
- Internal and total order cycle time performance
- Backorder levels and recovery time
- Orders filled complete (first pass yield)
- Order fulfillment accuracy
- Labor hours per \$1 million in sales
- Customer on-time fill rate
- Order placement to customer delivery process maps
- Labor hours per \$1 million in sales
- 3PL performance and contracts
- Transportation contracts
- Customer service/order management metrics and process maps
- Capacity utilization (seasonals)

### **Inventory Management**

- Inventory months coverage, obsolescence, excess
- Inventory as percentage of sales (materials, WIP, FG)
- Inventory turnover
- Carrying cost of inventory
- Cycle counts

### **Financials**

- Annual operating plans (prior and current year)
- Cash to cash cycle performance
- Cost of goods sold
- Revenue per person
- Transportation unit cost per cwt and as % of sales (by mode)
- Distribution unit cost as % of sales
- Direct and indirect labor cost
- Overhead contribution
- Activity based costing metrics

### **Other Considerations**

- Supply chain strategic plan and initiatives
- S&OP meeting notes (past 12 months)
- Competitor benchmarks/threats
- Key events-issues-acquisitions-dispositions

The preceding evaluation is done in tandem with the execution of the supply chain assessment and alignment process described below to provide a complete picture of the target acquisition’s operational and financial “health” and estimate potential hidden value.

## Identifying Potential Improvements in Supply Chain Performance

Our knowledge and experience also can be quickly and effectively leveraged to help a PE firm identify ways to improve supply chain performance—either in an acquisition target or existing portfolio companies.

We use our proven assessment and alignment process to thoroughly assess the performance and importance of more than 30 supply chain competencies to prioritize the highest-impact areas for operational improvements—and quantify the potential financial impacts of those improvements.

The process utilizes a Web-based survey tool to gather and compare perceptions from customers, suppliers and internal operations on the importance of, and performance against, supply chain competencies. By deploying this tool, we can expose opportunity gaps and differences in perceived performance across the organization.

In addition to quantitative insights, the process includes group participant discussions and one-on-one interviews, which serve a three-fold purpose:

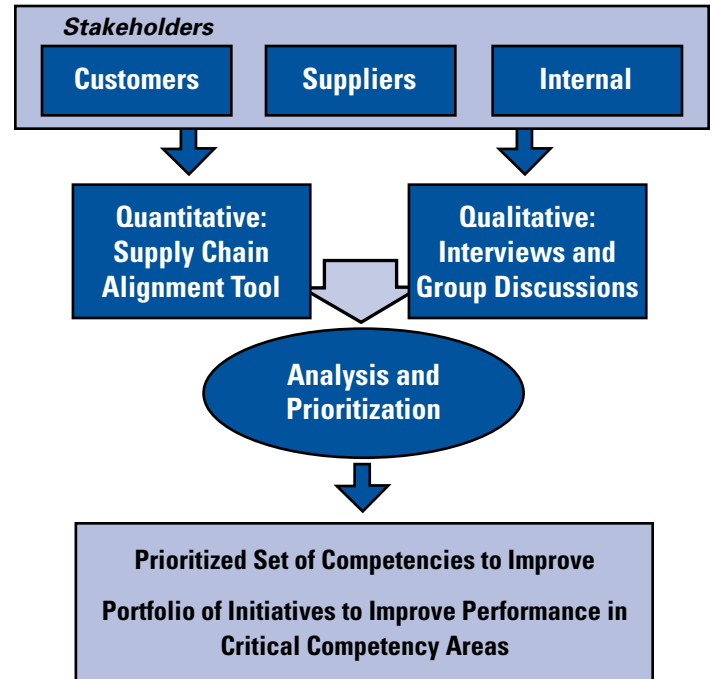
- Diagnosing opportunities to build or improve competitive advantage in supply chain capability
- Exposing barriers to reaching supply chain excellence
- Leveraging the knowledge and experience of associates, suppliers, and customers to identify improvement initiatives and reset supply chain strategy

Supply Chain Edge then helps analyze the information gathered in the assessment, identify causes of operational shortcomings, and create and execute a prioritized path to performance improvement across the supply chain (see figure). Importantly, the full process to create a prioritized list of performance improvement initiatives can be executed in just six to eight weeks.

A \$100 million manufacturer provides a good example of how Supply Chain Edge’s assessment and alignment process could benefit a PE firm in its search for performance improvement opportunities at prospective or current portfolio companies.

Working with Supply Chain Edge, the manufacturer found it could generate annual increases in productivity of between 5 percent and 6 percent by taking a number of key actions, including: implementing a market and product segmentation strategy, reengineering the order fulfillment process, improving demand planning, reducing freight costs, modifying sourcing strategies, and establishing optimal support systems.

Figure 1: Supply Chain Edge Alignment and Assessment Process



## Reducing Risk and Improving Performance

Regardless of economic environment, PE firms must scrutinize the operations of both potential acquisitions as well as existing portfolio companies carefully—which often can require outside help to complement PE firms’ already strong financial expertise.

Whether in need of a more robust due diligence review of operations or a boost in performance of portfolio holdings, Supply Chain Edge can help PE firms reduce the risk of, and generate greater return on, their investments in today’s challenging business and financial climate.

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## About Supply Chain Edge

Supply Chain Edge is a team of experienced supply chain advisors focused on delivering performance improvements in key areas such as business growth, earnings per share, return on capital, margins, cash-to-cash cycle times, and customer service. To that end, Supply Chain Edge is uniquely qualified to help companies accelerate cost-reduction initiatives, improve operational performance, drive best practices across the entire organization, and realize long-term and sustainable results.



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