Driving Value through Performance Improvement

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I. Executive Summary

The best management teams should always be seeking opportunities to maximize value, regardless of short and medium term strategy. Whether the strategy of a company is to remain independent, to grow by acquiring competitors, or to sell, every effort should to directed at maximizing the performance of a business, and hence its value.

With the support of experienced performance improvement professionals, small and midsize companies can substantially increase their profitability, cash flow and enterprise value by focusing on a few key areas.

II. Areas of Opportunity

- **Gross Margins.** Too many companies are unnecessarily complacent on the matter of their profitability, especially at the gross margin line. Healthy gross margins (a measure of profit that adjusts only for the cost of producing or providing the goods or services sold) are an essential feature in strong companies, and often gross margin erosion is an early sign of a problem in the business. Through detailed analysis of sales by customer and product/service line, combined with a related analysis of purchases from key suppliers, opportunities to increase gross margin can be identified, and steps can be taken to achieve substantial improvements in a span of months, not years.

- **Cost Structure.** Successful companies often find themselves in the trap of unexamined assumptions as key aspects of their competitive landscape shifts, but their cost structure paradoxically becomes increasingly static. An outside observer can often identify significant areas of improvement by switching fixed for variable costs, leaving companies with more flexible cost structures and lower break-even points.

- **Operating Expenses.** Cost savings opportunities can take many forms, and in the context of a comprehensive performance improvement process, they often do. Revamping commission structures, reorganizing key business processes, and outsourcing low value-add tasks are all proven methods of driving down operating expenses while also positioning companies for the strategic acquisition of additional high-value capabilities.

- **Working Capital.** The source of funds management has the most control over is not debt or equity, but rather internally generated cash. By focusing on the cash tied up in the normal operations of a business, or Net Working Capital, companies are often able to substantially improve cash flow, which allows for increased investment in promising business opportunities.

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III. Conclusion

Significant value creation is achievable through performance improvement initiatives. This illustrative example demonstrates how, with a limited number of areas of focus, the enterprise value of a small ($25 million) company can be increased by 78%, absent any increase in revenue. It is incumbent on the stakeholders of all companies to push for their organization to reach its highest potential. Regardless of size, the best strategy to ensure an optimal outcome is to achieve and maintain optimal levels of performance.

IV. Appendix

Exhibit A: Gross Profit Sensitivity

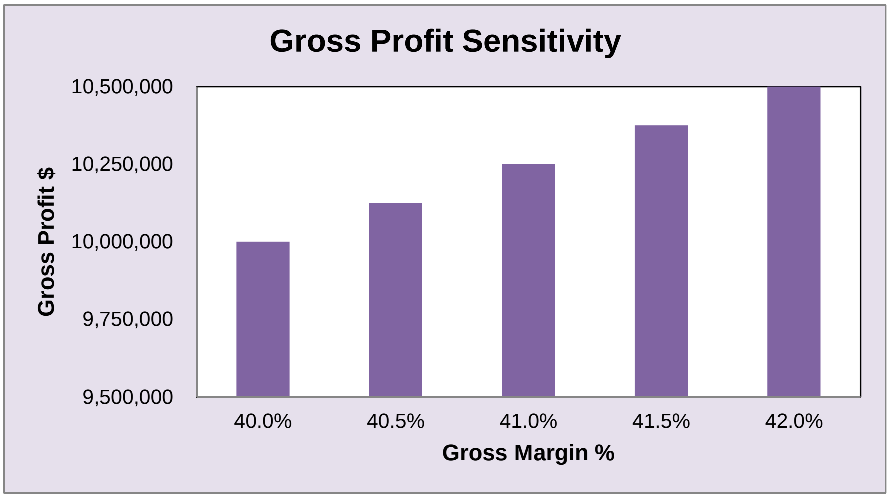

Exhibit B: Operating Expenses

	Original	New
SG&A		
Fixed	5,000,000	4,800,000
Variable	3,750,000	3,525,000
Total SG&A	8,750,000	8,325,000

Exhibit C: Cost Structure

	Original	New
Revenue	25,000,000	25,000,000
Cost of Goods	15,000,000	15,000,000
Gross Profit	10,000,000	10,000,000
Gross Margin %	*40.0%*	*40.0%*
SG&A		
Fixed	5,000,000	2,500,000
Variable	3,750,000	6,250,000
EBITDA	1,250,000	1,250,000
EBTIDA Margin %	*5.0%*	*5.0%*
Variable Costs as % of Sales	15.0%	25.0%
Contribution Margin %	25.0%	15.0%
Break-even Point	20,000,000	16,666,667

Exhibit D: Working Capital

Financial Ratio	Original	New
Days Sales Outstanding	45.0	40.0
Days Inventory Outstanding	90.0	80.0
Days Payables Outstanding	45.0	50.0
Cash Conversion Cycle	**90.0**	**70.0**

Balance Sheet Account	Original	New	Cash Flow Impact
Accounts Receivable	3,125,000	2,777,778	347,222
Inventory	3,750,000	3,333,333	416,667
Accounts Payable	1,875,000	2,083,333	208,333
Net Working Capital	**5,000,000**	**4,027,778**	**972,222**

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Exhibit E: Value Creation

	Original	New	Variance $	Variance %
Revenue	25,000,000	25,000,000	-	0.0%
Cost of Goods	15,000,000	14,500,000	(500,000)	-3.3%
Gross Profit	10,000,000	10,500,000	500,000	5.0%
Gross Margin %	*40.0%*	*42.0%*		*5.0%*
SG&A				
Fixed	5,000,000	2,400,000	(2,600,000)	-52.0%
Variable	3,750,000	5,875,000	2,125,000	56.7%
EBITDA	**1,250,000**	**2,225,000**	**975,000**	**78.0%**
EBITDA Margin %	*5.0%*	*8.9%*		*78.0%*

Variable Costs as % of Sales	15.0%	23.5%		56.7%
Contribution Margin %	25.0%	18.5%		-26.0%
Break-even Point	20,000,000	12,972,973	(7,027,027)	-35.1%
EBITDA Multiple	4.5x	4.5x		0.0%
Enterprise Value	5,625,000	10,012,500	4,387,500	78.0%

V. About Us

About the Firm

ACM Partners is a boutique financial advisory firm providing due diligence, performance improvement, restructuring and turnaround services. For more information visit: www.acm-partners.com.

About the Author

David Johnson is a founding partner of ACM Partners, a boutique financial advisory firm providing due diligence, performance improvement, restructuring and turnaround services. In his over 15 years as a change agent, David has served as an advisor, board member, interim manager, investor and operator at organizations ranging in size from pre-revenue startups to Fortune 500 organizations. David has several publications to his credit and is a regular speaker on the topics of performance improvement, turnaround and restructuring.

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