EXECUTIVE ISSUES & INSIGHTS

BUILDING ENTERPRISE VALUE THROUGH COST ALIGNMENT

nextLevel
BUILDING ENTERPRISE VALUE

Are you using the optimum cost structure to build value?

Understanding the relative costs of different parts of your business can inform your margin targets, pricing strategy, and marketing plans to drive overall net margins to your desired goal. Realigning costs to fit your optimum structure can also free up capital for needed investment, all of which contributes to better valuation.

In this edition of *Executive Issues & Insights*, we explore key insights drawn from the extensive C-suite and Board experiences of the NextLevel team on how to build enterprise value through cost alignment.

NextLevel Case Study

In-Depth Analyses of Manufacturing Process and Costs Leads to Improved Valuation

A newly formed company that manufactures and distributes nutritional bars was acquired from a protein supplement company. Because of misaligned manufacturing costs and limited available credit, the company was experiencing constrained cash flow.

The company engaged an experienced financial executive, now a NextLevel team member, as interim CFO. He quickly directed and led an in-depth analysis of the manufacturing process, including standard costs make-up, raw material costs, labor rates, and processes. This analysis resulted in an adjustment of the true costs of company products. It also led to the realization that production volume needed to be increased significantly to achieve economies of scale and that moving to an outsourcing arrangement for packaging would accomplish this.

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NextLevel Insights

Rethink your business as if you were starting from scratch

Across-the-board cost reductions assume all activities are still valid. Instead, think what you would do differently if you were just starting out. Centralizing your location and eliminating far-flung operations could result in the need for fewer people, for example. Question costs that were important in the past while taking a complete view of your business. Have a rational allocation methodology that looks at what is required to achieve your desired outcomes over the next two to four years.

Look at product-level profitability

Do a deep dive into the detailed costs for each product. Are they rational given the level of associated revenue? A thorough examination can uncover inefficiencies, product problems, or revenue slippage that contribute to profitability issues. Premium-level costs for a low-growth product may not be warranted. Understanding what your optimum cost structure should be for each product can provide clarity when setting pricing and marketing plans, as well as capital investments.

Use right processes

When processes are fine-tuned, everything flows through your system with the fewest people possible tracking each item—order, invoice, customer service call—and only the exceptions get extra attention. When multiple people have to handle every instance, it costs time and money. Process problems plague growing companies who didn't think they needed formal processes when they were small. Investing in good processes up front keeps costs aligned with value-creating activities.

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In addition, the NextLevel executive performed a detailed review of the credit facility agreement with a focus on accounts receivable and inventory that secured the facility, along with "ineligibles" that reduced the borrowing base under the credit agreement. By understanding the borrowing base and ineligibles, the accounting team was able to focus on timely collection of accounts receivable and clearance of discounts taken by retailers to improve inventory aging. These efforts resulted in a faster turnaround from point of sale to collection, increasing cash flow by 12 percent.

Lower basic costs, reduced inventory carrying charges, and other working capital improvements resulted in higher EBITDA. The increase and stability of cash flow resulted in a better valuation multiple. Reducing the ineligibles in the borrowing base created more borrowing headroom under the credit facility, providing additional funds to invest in product growth opportunities. As a result of all these factors, enterprise value increased.

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Review compensation and incentives

As your products and services evolve, so do your salespeople's jobs. A product that needed a lot of evangelizing in early years likely needs less active salesmanship as it matures. If you don't realign compensation structure, incentives, and bonuses over your product's life cycle, these costs can eat away at profits. A comprehensive review will help ensure those costs are appropriate and aligned around delivering on long-term objectives.

Take a closer look at working capital

Some costs, such as those from carrying excess inventory, a slow collections process, discounts taken by retailers, and poor credit management, reveal themselves when you review current assets and liabilities on your balance sheet. This can help you improve and stabilize cash flow, which can result in higher EBITDA and generally also a better valuation multiple.

Be smart about headcount reductions

Companies often hesitate to let go of managers and executives when reducing headcount. But not doing so may leave your workforce demoralized and the organization top-heavy, with a need to rehire workers as contractors later. Make strategic cuts from all levels to realize efficiencies during a reduction. But be reluctant to let go of thought leaders at any level or you may make it harder to achieve your strategic vision. Evaluate where you would be in three to five years without the person before letting them go.

"A DETAILED COST ANALYSIS CAN FREE UP A LOT OF OPPORTUNITIES THAT CAN BE MISSED AT A HIGHER LEVEL."

Costs can be shifted to activities with better returns.

KEYS TO BUILDING ENTERPRISE VALUE THROUGH COST ALIGNMENT

- **Your business:** Can you think about it as if you were starting from scratch?
- **Your products:** Are you examining the detailed costs against revenue for each?
- **Your processes:** Have you invested in making sure they are fine-tuned and efficient?
- **Your compensation and incentives:** Have you reviewed and reset them lately?
- **Your working capital:** Have you reviewed current assets and liabilities for hidden costs?
- **Your headcount:** If you need to reduce, are you being smart about it?

More Information

To learn more about how NextLevel can help you build enterprise value through cost alignment, call us at (800) 833-NEXT or email info@nlbev.com

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