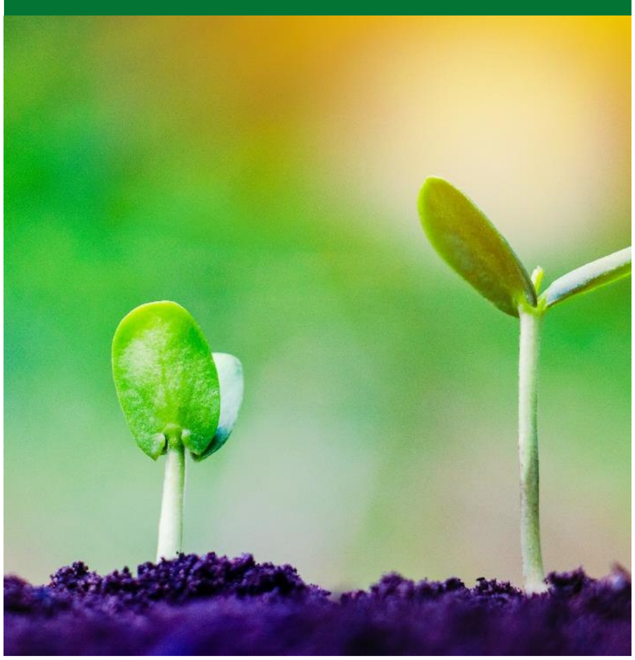
VALUE CREATION IN HEALTHCARE SERVICES, MANUFACTURING & INDUSTRIALS, AND BUSINESS SERVICES

ACG Toronto Value Creation Series, Presented by Sapling Financial Consultants Inc.

In today's market, value creation initiatives are crucial for PE firms to build a foundational basis of support and drive growth in portfolio companies. This is especially important as PE firms increasingly cannot expect that the exit EV/EBITDA multiple of the business will necessarily be higher than the purchase multiple. The function of value creation is split between "Business Development" teams, which originate and evaluate investment opportunities, and "Investment" teams which analyze investment opportunities, complete acquisitions, and work with portfolio companies. At some firms the Investment team has broken out a separate Portfolio Support, Value Creation or Internal Consulting team to drive these initiatives so as to reduce "distraction" from the urgency of dealmaking.

CREATING VALUE THROUGH VARIOUS LEVERS

Value Creation can be driven by making use of various levers at the portfolio company level, including sales & marketing, operations, HR, IT, legal, and finance. Sapling Financial Consultants Inc. ("Sapling") focuses its value creation driving activities around the financial planning & analysis ("FP&A") and reporting functions, with services including development of Business Intelligence systems, build-out of financial models, and creation of detailed costing models. This whitepaper explores value creation initiatives relevant to various industries, including healthcare services, manufacturing and industrials, and business services. These findings are all summarized from ACG Toronto's Value Creation Series, for which Sapling was the lead sponsor.



HEALTHCARE SERVICES

Speciality medical practice roll-ups are popular targets amongst PE firms due to the opportunity for growth because of economies of scale, increased knowledge and resources at each clinic, and cross-selling.[1] Before executing this strategy, PE firms should identify attractive targets and conduct IT due diligence to best drive value.

ACQUISITIONS

Investors can assess companies to acquire through the following criteria: relative attractiveness, adjacency or familiarity, and specialization. Consolidating specialized practices has become an attractive proposition since the rolled-up entity becomes a 'one-stop shop' for all relevant goods and services. Value is also added by achieving economies of scale through lower costs and improvements in quality and convenience. Another critical aspect is to assess the company's business model; for instance, recurring revenue models are common in some types of dental practices, thereby allowing for better-managed cash flow and more predictable revenue streams.[2] These steps allow investors to identify whether the target's business model aligns with the entity's long-term objectives to grow sustainably.

IT DUE DILIGENCE

Having the ability to slice and dice data and consolidate metrics is extremely useful for ongoing performance monitoring and analysis, as well as running ad-hoc analysis and comprehending large datasets quickly. Tools like Power BI dashboards can report on KPIs such as current month completed patient starts, patients' receivables by practice, current month completed consults, or appointments by status. It is important to analyze if this data is being captured during due diligence, so that advanced tools can be leveraged during the hold period to extract data and provide insights that can improve performance.

CONCLUDING REMARKS: HEALTHCARE

To execute a successful roll-up, PE firms must correctly identify targets and locate opportunities through IT due diligence in order to drive value creation.

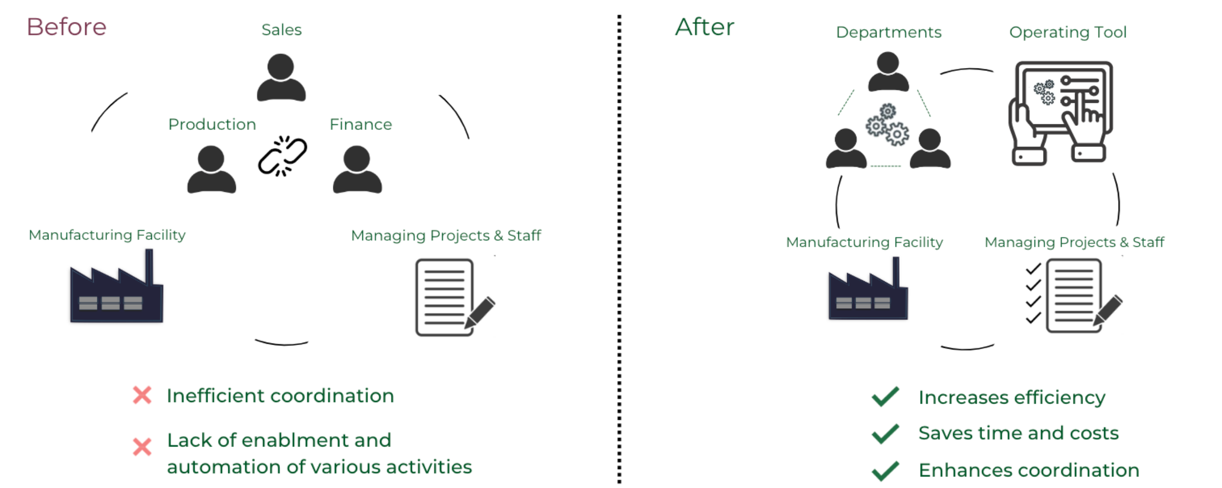
MANUFACTURING & INDUSTRIALS

Manufacturing encompasses process operations that are capital intensive, in comparison to industrials, which often possess a capital-light business model. Key value creation levers in manufacturing and industrials include supporting existing management, leveraging technology, driving sales & marketing, and improving supply chain operations.

SUPPORT EXISTING MANAGEMENT

Leveraging management's existing knowledge to inform a value creation plan is crucial to support decision-making processes, despite management not having experience in M&A or managing the vast resources that PE firms can often bring to bear. For example, although management has extensive experience managing projects and staff, there may be room to facilitate efficient coordination between the sales, production, and finance teams as shown in Exhibit 1. To make decisions about what strategy needs to be implemented, PE firms can bring in outside resources, such as a management consulting firm that provides financial modelling and data analysis to help the business make better decisions based on quantitative facts. For example, a consulting firm can develop a plant scheduling tool that reflects project task scheduling, staff scheduling on a day-to-day basis, and calculations of labour variances. As a result, value is created as management has a high-level overview of the upcoming workload and the tool becomes an integral part of how the manufacturer manages the plant.

Exhibit 1: Manufacturing Example – Plant Scheduling Tool



Conversely, existing management has first-hand experience of the business that PE firms can leverage; for example, only management would understand the nuances of a typical customer and be able to close contracts based on learned responses, which have been identified through trial and error.

TECHNOLOGY

Rapid advancements in technology have led to tools that can drive value creation in manufacturing and industrials, most significantly when it comes to operational efficiency. For instance, one of our clients was an automotive manufacturing company looking to extract detailed insights from multiple unlinked systems and produce operational reports through a less manually extensive process. The solution involved building an auto-refreshed dashboard that consolidated key financial, operational, and supply chain metrics (e.g., trailing twelve month sales by product class & customer group, monthly sales orders, etc.). The automated system resulted in an efficient process to track real-time performance of a complex downstream supply-chain and provided detailed insights to monitor performance and make adjustments as needed.

SALES & MARKETING

One method to drive sales growth is to provide benefits to management and sales teams directly correlated with company success, such as providing growth shares over and above a 'hurdle' (the minimum amount for which the growth shares become eligible for economic return).[3] This helps sales teams to gain momentum and provides extrinsic motivation to make the sales team a key partner in achieving a desirable equity value before exiting.

Improving product positioning can also help to drive sales growth in manufacturing and industrials, either through selling high volumes of low margin products or low volumes of high margin products. Since value creation is related to sales growth, it is crucial to encourage sales teams to identify what strategy works best and to recognize factors to adjust (e.g., sales volumes, profit margins, product lines). For instance, if the rate of customer acquisition is declining through quality-based positioning, a company might consider using a competitor's product to highlight the benefits of their own product.

SUPPLY CHAIN MANAGEMENT

The global pandemic and the Russian-Ukrainian War is forcing companies to reassess their supply chain management and consider reshoring production. However, one complexity of reshoring is labour and the competitive environment for human capital.[4] Consequently, reshoring can be risky and potentially cause inefficiencies that maybe be difficult to counterbalance.

A general rule of thumb to apply here is the 80-20 rule – in which a company reshores 20% of operations as a process of testing and analysis before moving forward with the strategy. Companies can then weigh options to reshore, offshore, or apply a hybrid production model before making changes. This decreases exposure to market forces, mitigating increased production cycles, and combatting supply chain issues moving forward.

CONCLUDING REMARKS: MANUFACTURING & INDUSTRIALS

Both industries have unique aspects that need to be considered to drive performance. Strategies such as leveraging existing management, leveraging technology, and improving sales, marketing, and supply chain management can all help to increase value.

BUSINESS SERVICES

Key value creation levers in trade-related business services include driving sales growth, attracting and retaining talent, and optimizing supply chain operations. Meanwhile, value creation levers in professional services include attracting and retaining talent and the ability to enhance operating tools.

TRADE RELATED SERVICES: DRIVING SALES GROWTH

Traditional sales and marketing approaches include printed ads, direct mail, and cold calling. Buyer behaviours have undergone drastic changes, thereby making it difficult for businesses to rely on traditional methods to drive value. Consequently, sales and marketing departments in trade-related services may find themselves more restricted due to increased costs, a lack of measurement, and less segmentation of consumer demographics. Thus, it is important to pinpoint deficiencies and make the most out of the available resources to drive sales.

One technique for benchmarking sales is to generate key wins/losses reports and make them accessible to sales teams to highlight positive and negative sales outcomes.[5] For example, if a high-performing sales representative recently closed a competitive deal, assigning a team member to interview the client can help drive sales by providing insight into best practices and enhance knowledge sharing within the company.[6]

TRADE RELATED SERVICES: ATTRACTING & RETAINING QUALITY TALENT

Making workers feel safe and supported is an integral part of attracting and retaining quality talent. Quality talent is crucial in this industry to ensure customers receive high-quality service that builds a strong reputation. Fostering a culture of safety takes more than just having the right equipment – it requires well-structured safe work practices, and accounting for mental health. When employees feel safe and psychologically well, they are less likely to experience incidents which would cause them to leave/put the business at risk of litigation or poor reputation.[7] Retaining and attracting quality employees can also be achieved through extrinsic incentives such as perks and benefits, including travel, time-off, bonuses, and training.

Although the acquisition target may have an existing union and agreement, it is crucial to remain knowledgeable about the relationship between the business and union. Speaking with the current owner can be a good starting point to address any concerns. Understanding the bargaining agreements, pension packages and any other conditions can help in recognizing the resources and limitations of the business and any opportunities to leverage upward mobility. This is especially helpful since unions play a significant role in attracting and retaining quality workers.

TRADE RELATED SERVICES: OPTIMIZE OPERATIONS & SUPPLY CHAIN MANAGEMENT

Optimizing supply chain management can help to improve efficiency, control costs, and avoid shortages. One way to create value is to implement technology that reports on operational metrics to identify areas of operations that can be more efficient in terms of time, cost, and resources.

Procurement practices such as fleet rationalization can be applied to drive value in supply chains. This entails partnering with vertically integrated manufacturers with in-house distribution services rather than companies with outsourced fleet management providers. Vertically integrated partners (or vertically integrating during the hold period) can help cut costs; however, the risks (e.g., hyperfocus on efficiency, varying delivery times) should be diligently assessed before making changes.

PROFESSIONAL SERVICES: ATTRACTING & RETAINING QUALITY TALENT

Talent is not only critical in professional services, but it can also be scarce. To attract and retain talent, firms need to show that they can provide growth and advancement opportunities to facilitate career growth. Although initiatives such as training programs or learning sessions can enhance transformative learning, it is also important to provide employees with opportunities to experiment and work on projects to expand their horizons.[8] By encouraging employees to acquire on the job skills, value is generated as the organization becomes a breeding ground for continuous talent development.

Firms should also be able to assess projects where external expertise is required. There are growing opportunities for professional firms to connect with external talent, especially once identifying gaps in know-how that need closing from external resources. For example, hiring a boutique consulting firm with industry experience and deep subject-matter expertise can be a cost-efficient option and result in specific, customized objectives that can meet one's project needs.[9]

Importantly, firms who are able to develop strong relationships between internal employees and external expertise helps to create value as organizations will gain a competitive advantage as opposed those who only focus on growing internal resources.[10]

PROFESSIONAL SERVICES: ENHANCED OPERATING TOOLS

Implementing enhanced reporting tools and mission critical spreadsheets can be effective for driving value and can save time for management to make informed decisions. To illustrate, one managed services firm wanted to gain insights into how to better manage costing and increase profitability. The solution was to create monthly detailed client costing worksheets that provided margins for every client based on employee workload, travel expenses, server and hosting costs, and product costs. The findings led to re-examining customer pricing and invoicing, improving the tracking of employee hours, and shifting the business towards more profitable service offerings.

CONCLUDING REMARKS: BUSINESS SERVICES

Like any other sector, business services come with their own set of opportunities and challenges when deriving a value creation plan. In trades-related services, driving sales growth, retaining talent, and implementing procurement strategies can help to add value. Meanwhile, professional services require attracting and retaining talent and enhanced operating tools to drive value creation.

CONCLUSION

While healthcare, manufacturing and industrials, and business services continue to evolve, the competitive landscape is also changing faster than ever. Value creation initiatives are key to establish success in portfolio companies. In a dynamic healthcare market, value can be created by rolling up an industry/geography and conducting IT due diligence to execute those roll-ups. In manufacturing and industrials, leveraging management, automating processes through technology, and improving sales, marketing, and supply chain management are all drivers of value creation. Driving value in business services can be achieved by increasing sales, retaining and attracting quality talent, and improving supply chain efficiencies in trade-related services. On the other hand, for professional services, developing talent and enhancing operating tools can drive value. Not only is developing a value creation plan critical, but knowing which levers are most impactful for each industry helps to best allocate resources and maximize ROI.

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