

## **Private investment firms and value creation in manufacturing**

When valuations of business are stretched in an environment of low interest rates and excess capital, what can private equity firms do to make money from their holdings? Add value, says experts. That sounds simple - but how?

MNP's Hussam Malek asked three private equity firm leaders how they approach this challenge during a panel discussion held as part of the Association for Corporate Growth's (Toronto Chapter) value creation series.

Below are insights from Shannon Martin, Principal at Fulcrum Capital, Johanna Salloum, Partner and Senior Director of Investments at PFM Capital and Anthony Creo, Vice President of Ironbridge Equity Partners, shared during the panel discussion.

**What are some of the value-creation initiatives you consider for manufacturing companies, both as you're developing your investment memo / business case, and once you actually own the company?**

Johanna Salloum said one of the first things PFM Capital does going into a new deal is assess how experienced the management team is with mergers and acquisitions, and plan to step in at the right level that accords with management's experience and capability. That way the firm has a strategy for building a platform company at the onset.

"Another way we find ourselves creating value once we are in is on the management team side. Whether it's planning management succession, or upgrading members of the management team, we find that we play a pretty large role there," Johanna added. "Historically, we've been hesitant about making management changes because of the perceived risk involved, but as management is key to the success of a business, and there's lots of talented people out there, it's often the right decision to make a change – and we've seen some pretty quick results once we've done that," she said. This also plays into assessing a good opportunity that might not have a strong management team. Rather than bypass it, the firm would rather get into the company and tweak management to grow and shape the company, building off the stronger team.

**Do you get involved with making operations more efficient? If so, how? How have you been using software and technology to drive value?**

Shannon Martin voiced what the other panelists agreed with: management runs the company and, in most cases, knows how things operate better than the private equity firm. But one of the areas where Fulcrum Capital adds value is being able step back and identify where other resources might be needed, whether through different advisors, consultants, or experts. Part of this is reassessing things like return on capital investment and resetting your course, if required.

Benchmarking against industry peers also is a way to make operations more efficient, either benchmarking operating metrics or even staff, Shannon said, to evaluate the quality of your workforce, or different things like the financial side – margins, pricing, inventory management, etc.

“Definitely technology and data and systems are driving a lot of these processes,” she noted. “There has been rapid evolution over the last decade, in terms of the amount of information that companies are tracking. And being able to use that data to optimize things like reducing your lead times and minimizing waste helps us optimize everything – we are finding opportunity in nearly every single one of our portfolio companies.”

**Do you get involved with the product side of the business – e.g., adding, removing SKUs, or rationalizing them, etc.?**

Management is ultimately the one that’s going to understand the nuances of a particular product, but often doesn’t have the opportunity to flesh out new ideas, said Ironbridge Equity Partners’ Anthony Creo. “What we are going to come in and do is provide that rigorous process to make a good decision, versus going off a gut feeling.”

That would start with product line profitability analysis. “Can we get rid of the dogs, or are we bidding on things as a family of parts, so you have to take the good with the bad? Do we need the work for overhead absorptions, so it’s better to be there than not to be there at all until we reach capacity issues? Or is it strategic – are we trying to break in with a customer and be willing to take a hit at first,” Anthony queried. “So, we are going to help with that analysis, which then drives good discussions and strategy.”

**What do you think about reshoring (i.e., moving more manufacturing/supply chains back to North America)? Is this part of your strategy? If so, what are some of the challenges with this?**

All three panelists agreed one of the biggest struggles around bringing back manufacturing to North America is labour – and the competition for skilled, trained workers. Johanna said increasing wages is one tactic, along with efficient training programs. “The challenge with training is you generally lose efficiencies as the experienced workers take time out of their day to train the new ones,” she added.

Private equity firms have to be cognisant of the costs of pivoting, both in operations and human capital, Anthony said. “I think the silver lining there would be it doesn’t have to be a binary decision: There’s a spectrum - you don’t have to repatriate everything. You can find pieces of that process that make sense.” For example, one company in the firm’s portfolio was fully manufacturing in Canada and the U.S., but the firm found offshoring some parts was more cost efficient. Conversely, it didn’t make sense for another company to keep manufacturing offshore because of tariffs and transit times.

“So, I think looking at the defensibility of your manufacturing position before you buy it is critically important to avoid too much of the brain damage on the offshoring / reshoring topic,” he said. “But it’s a complex topic, for sure.”

For Shannon, the next phase of supply chain issues – which in large part was the driver of reshoring, particularly during the pandemic - is going to be about flexibility and data. “Having different options, where you can move things around and understanding where the best place is to manufacture or source different components, is key,” she said. “At the same time, as this

pandemic and these challenges in our supply chain unfold, you also have these rising input costs where labour cost is going up, different material costs, real estate, the cost of freight and transportation. A lot of factors are in play, so being flexible and knowing what your options are, whether it's offshoring, reshoring, or multiple sources, that is going to be the key going forward."

**Do you stay with the standard or look at diversifying – products and customers - with an eye toward an exit, to make yourself more attractive to buyers? If you are too concentrated on a specific product line, customer base, sector, is there a risk on exit?**

Anthony's firm is constantly looking at ways to expand into adjacent industries to expand those skews, or customers, he said. "That nine times out of ten is how we are growing; with existing customers, selling them adjacent products or getting new customers. We are always running towards trying to improve those two dynamics, but whether we're successful or not is case dependent."

**What are the challenges of building a direct sales team while maintaining distributor relationships?**

"Having a really professionalized sales strategy – one portfolio company uses the Canadian Association of Professional sales program – and really embedding it in their culture is one way, said Johanna. "Having a good and rigorous training program within the culture, and then having multiple touchpoints of additional training helps balance the one with the other."

"One of the things we do right out of the gate with each investment is define a sales strategy," said Shannon. "The other side of that is specifically defining a sales strategy to identify the things you want to do. For example, we might not maintain a direct sales team because that's not our strategy with this company. And that way you can focus on your distributor relationships, if that's your way to approach the market."

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