



Private Equity Insights

With a tightening economy squeezing their investments, private equity firms are aggressively seeking new ways to wring more cash from their holdings.

According to Standard & Poor's June 2007 *Leveraged Commentary & Data*, companies purchased by PE firms have watched cash-to-debt ratios fall 50% in the past three years, from 3.4 to 1.7, a ten-year low. With financial market problems now limiting buyout financing, PE firms are easing up on acquisitions and holding onto some companies in their portfolios longer. These factors intensify the pressure on PE firms to improve performance levels of their holdings to satisfy investors, as well as make them more attractive to prospective buyers.

"We believe that to achieve those levels," says USC Consulting Group (USCCG) President George Coffey, "PE firms will have to dig deeper into their holdings' operations to identify the substantial opportunities for generating more cash and making them operationally stronger."

"To do that, PE firms will need to make substantial improvements in the

operations of the companies they hold in areas such as productivity, asset utilization, cycle time, quality improvement, SG & A reduction, and supply chain optimization. Most PE firms have traditionally shied away from operational improvements like these in favor of one-time 'structural'

"We have found that operational improvement can boost the finances of even the best-performing companies by as much as 10 to 20% increases in EBITDA."

improvements like consolidating assets or selling off extraneous business units."

But when PE firms don't pursue operational improvement opportunities

after implementing these structural improvements, they leave a lot of cash on the table. Coffey claims, "It would not be unusual for them to see savings of three to four times return on investment from operations improvement initiatives in even their best-performing assets."

The Need for Greater Visibility

Gains like these are possible only with acute visibility into the health of holding operations, i.e., uncovering where waste, extra steps, errors, and process problems exist in a company's core operations. This is true both prior to and after an acquisition is made. However, getting to this level of detail and unlocking hidden value seems far from easy for private equity teams, maintains Tom Klebeck, USCCG's director of finance and administration, because of:

- difficulty in identifying opportunities;
- reluctance to interfere with portfolio companies' management teams;

continued on page 2

In This Issue

Private Equity, cont.....Pg 2
 Improving OEEPg 4

Improving OEE, cont.....Pg 5
 MINExpoPg 5



- perceived complexities and risk in achieving process improvements; and
- aversion to extra headcount and cost for achieving desired outcomes.

Of the first barrier, Mr. Klebeck says, “Many PE managers we’ve spoken with say they don’t have the wherewithal to determine the extent of possible operations improvements. As a result, they are unable to easily identify opportunities that can make a significant financial difference for them.”

Before an acquisition, PE firms need information that will provide insights into potential operational efficiencies. But this kind of information can seem foreign to many PE firms because of their financial orientation. Mr. Klebeck contends that, “PE managers are comfortable when operational indicators are aggregated, particularly when that summary is attached to a dollar figure. But when operational indicators are rolled up to an aggregate level, they can hide significant variances.”

For example, a transportation company can report a 95% on-time performance across its divisions, i.e., shipments arrive on time to customers 95% of the time. Yet, it may have a much poorer on-time performance in one or more of those divisions, or in regions of those divisions. A lot of operational reporting of variances and thus identification of operational improvement opportunities are hidden because of the way reports are aggregated and variances calculated. This is why it is absolutely essential to know where to look for the details underlying the macro numbers.

The second issue is one of management autonomy versus management effectiveness. Many PE firms want supportive-but-hands-off relationships

with acquired companies. PE firms typically believe, for numerous reasons, that the management teams they put in place to run their portfolio companies are best equipped to make operational decisions, which, for the most part, is true. Too often, though, the team does not have the tools or information for identifying new ways of running their operations, let alone the capacity to manage multiple strategic and tactical initiatives. Simply giving management an ownership stake in their business is not likely to help them see its operations

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in whole new ways that would help them net the cost-savings efficiencies that could favorably impact their bottom lines.

The perceived difficulty in capturing value from process improvements is the third impediment to gaining operational efficiencies. According to Mr. Coffey, “PE firms often lack in-depth operations experience and, so, believe that nailing down cost savings and other benefits from rethinking processes, as opposed to making structural changes, are too problematical. They think that the changes, and therefore the cost savings, won’t be sustained,

or that the costs simply will shift elsewhere and never materialize on the bottom line.”

The final barrier to visibility is PE firms’ aversion to adding headcount and cost to their operations. Most PE firms have limited operational expertise on staff, although some may put an industry-experienced resource in place to protect their interests. But, as Mr. Coffey says, there’s no substitute for having “boots on the ground,” meaning intensely focused, highly trained subject matter experts who know how things should or should not work, and who have the ability, tools, and people skills to set them right. Slowly but surely, many PE firms are beginning to recognize that stinting on operational expertise leads to lost opportunities and are aligning themselves with outside management consulting firms to help them realize financial gains without adding to overhead.

Targeting Operational Gains

Pursuing operational efficiencies doesn’t have to be risky. Efficiencies can be secured without undermining executive teams and they can generate some surprising benefits, both in cost savings and new revenue from accelerating manufacturing output and improved product and service quality.

It is easy to understand how focusing on operational improvements can help PE firms boost performance in their lagging companies, but it is important to realize that this approach can reduce risk in the acquisition process and bolster the bottom lines of better-performing holdings, as well. In fact, identifying operational efficiencies at each stage of portfolio companies’ lifecycles can create benefits that would otherwise be hidden.

continued on page 3



Private Equity continued

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Where to Look for Operational Efficiencies

Private equity firms can unlock hidden value in their portfolios in six basic ways, all of which will free up working capital.

Productivity increases result from identifying and eliminating such semi-variable costs as maintenance, shipping and receiving, or from reaping process improvements across consolidated operations.

Asset utilization gains come from improving the way a piece of equipment is operated, which accelerates throughput and decreases the need for new equipment investment; and from reducing inventory costs by accelerating inventory turns or using less inventory to support the same sales volume.

Cycle time reductions made in the manufacturing and distribution processes can slash the amount of time required to produce and deliver a product, accelerating order-to-cash velocity.

Quality improvements such as reducing process variation that leads to over-fill and other forms of giveaway to increase material yields. They also reduce product defects and warranty costs and claims, as well as rework and scrap.

Sales, general and administrative (SG & A) reductions in such forms as decreasing indirect labor and duplicate structures and overhead, as well as institutionalizing best practices with technology are critical to freeing up working capital.

Supply chain optimization includes rationalizing supply chain requirements; improving procurement practices; optimizing cycle and lead times; implementing systems and processes to manage and control work; developing effective linkages between each of the supply chain nodes; streamlining logistics; improving customer service; and developing meaningful metrics.

The Right Tools

Clearly these operational improvements can have a solid impact. But, Mr. Coffey emphasizes, all require the PE firm to have the ability to drill down into the operational details of its holdings, know what to look for, prioritize and quantify the opportunities, and implement change. PE firms also must look into their businesses at multiple levels, including plants and manufacturing lines, right down to SKUs and customer satisfaction levels.

This requires establishing a set of key operational metrics and using a set of tools that will provide real-time visibility to the state of operational performance. It also requires that executives put into place the discipline for reaching those metrics and hold management accountable for attaining their goals.

Mr. Coffey and Mr. Klebeck agree that PE firms must give their company managers the right tools, information systems, processes, and coaching, which they refer to as the *management operating system*, to meet their new performance objectives.

“It’s not about getting new information systems,” Mr. Coffey clarifies. “It involves formal tools like business intelligence portals that can capture, analyze, and share information, as well as informal tools like meetings, method-

sharing, and so on. In other words, it means reviewing, and possibly changing, all the tools managers use to understand and manage the flow of their materials and products across the entire supply chain. That, in turn, requires teaching people how to operate in a new process and to use the new information and tools they have to realize the financial gains that operational improvements can generate.”

The Final Analysis

The tense business climate for all private equity firms means they will need new weapons in their arsenals to continue the kinds of stellar performance they’ve experienced over the last ten years. Those that focus on operational improvements, in addition to structural moves, may find their portfolio companies performing beyond their wildest dreams, both while they are being held and after they leave the PE fold.

For more details on how private equity firms can benefit from operational improvements, access the white paper *Unlocking the Hidden Value in Portfolio Holdings*, by USCCG President George Coffey and Director of Finance and Administration Tom Klebeck at www.usccg.com.



Improving OEE Through Asset Performance Management

Increase coal production without significant capital investment

By Adam Aguzzi,
Project Manager, CMRP

In recent years, mining companies have experienced massive growth in fixed assets, which have increased from \$61 billion in 2003 to \$110 billion in 2006. This is the result of monumental commodity pricing increases, which have ranged from a low of 25% to a high of almost 500% in the same time period.

The opportunity to leverage fixed assets has never been greater, but these same assets have never been more expensive to maintain and operate, which has diminished profitability of increased production. In response, one major international energy company called on USC Consulting Group (USCCG) to help ensure that its rising fixed asset costs would generate an equal return in production. This was a unique opportunity for USCCG to develop and implement an entirely new reliability maintenance and management program across the coal company's multiples sites.

Before redesigning the Asset Reliability Program, USCCG trained and equipped the mining company's Core Teams in the analytical and facilitation skills they would need to make the transition from the old to the new maintenance management program. For two months, the Core Teams received instruction in EXP™ Work



Management software, Maintenance Task Analysis (MTA), and Reliability Centered Maintenance (RCMII), and the associated technical and facilitation skills they would need over the coming three years.

“The opportunity to leverage fixed assets has never been greater...”

During the next four months, USCCG mentored the Core Teams as they conducted MTA and RCMII

analyses on three large assets: a CAT 789B haul truck (pictured above), a CAT 5130B track hoe, and a P&H 4100 shovel. Core Teams assigned to each asset consisted of subject matter experts including asset operators, mechanics, electricians, and corporate management.

Through Work Identification methodology, the Core Teams were able to determine the proper equipment maintenance requirements and intervals, so that the right work would be done at the right time.

By developing Preventive Maintenance (PM) using condition-based indicators, scheduled restoration, and discard

continued on page 5



Improving OEE continued

intervals, the company was able to build a successful proactive maintenance system to replace its outdated "fix-it-at-failure" approach.

When the Work Identification was completed on each asset, the Core Teams developed a new Asset Reliability program consisting of updated PM check sheets, inspection routes and modifications to the assets to address safety, environmental, and operational concerns. As each group completed its task, the company was able to use the findings as a template for achieving the same results at all of its sites worldwide.

As the Asset Reliability Program was unfolding, current operations still needed to be measured and controlled. By developing a core set of leading and lagging KPIs, maintenance and operations were able to tackle work management issues that fell outside of the work identification project. Using the KPIs, the mining concern was able to determine where it stood in such

areas as schedule attainment, percent of work planned, percent of proactive work, backlog, and Mean Time Between Failure.

Once these benchmarks were established, the mine implemented and monitored work management controls to reduce downtime, and increase tonnage per truckload, equipment unitization, and adherence to scheduled hours. Measuring and controlling these issues helped to avoid erosion of overall equipment effectiveness (OEE) by streamlining production and maintenance.

Over the next three years, this mining company is projected to realize an ROI of 3:1, with estimated gains of \$10 million or more in the first year. This is based on dramatically improved reliability of every major asset, the happy result of integrating the benefits of an overhauled reliability system with a more informative and controllable operating system.

The increase in availability will improve tonnage for all existing assets

and allow new assets to come online using the same reliability program. The company now has the knowledge and tools it needs to continue down the path of success.

For a more in-depth look into how USCCG helps mining companies increase production without making significant capital investment, visit www.usccg.com.

About the Author

Adam Aguzzi has been instrumental in developing USCCG's Asset Reliability Practice. He is a Certified Maintenance and Reliability Professional (CMRP) as approved by the Society for Maintenance & Reliability Professionals (SMRP), and certified in production and inventory management (CPIM) by APICS (American Production and Inventory Control Society).

USCCG to Rock at 2008 MINExpo



USC Consulting Group (USCCG) will be exhibiting at MINExpo International 2008, sponsored by the National Mining Association, September 22 - 24 in Las Vegas.

The firm's veteran mining industry experts will be on hand to share their insights on everything from asset performance management to the latest IT developments for mining application. The USCCG team will include:

- David Riggs, senior regional manager for the Pacific and Midwest Regions;
- Joe DiNapoli, senior operations manager;
- Dean Carrier, senior operations manager;
- Jack Korpela, senior business

- development executive;
- Jim Littlefield, business development executive; and
- Gary Brown, director of marketing.

During its 40 years in business performance improvement, USCCG has worked with a number of mining companies, among them Barrick Gold, Cleveland Cliffs, INCO, Meridian Gold, North American Palladium, and Placer Dome. Visit the firm's web site at www.usccg.com for more information.





First we make it work. Then we make it last.®

For more information contact us at **800-888-8872** or www.usccg.com

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