MMEC CASE STUDY

Category: Transition Readiness/Change of Control
Manufacturer: PDM

HOW TRANSITION READINESS CAN EASE THE PAIN AND PREPARE YOU FOR SUCCESS

MONTANA MANUFACTURING EXTENSION CENTER

PART OF THE MEP National Network™

When a small business undergoes a change of control, it does not always occur under ideal circumstances. The most common events that initiate a change of control are death, disability, divorce, disagreement, and distress. As a result, owners may not have the time, support, or resources to carefully plan for the transition, and are less than satisfied with the outcome.

By contrast, when business owners initiate the change of control themselves, they have an opportunity to help shape the transition, and the sale terms and conditions – if they are well-prepared, well-supported, and maintain focus. This case study illustrates a successful change of control by an injection molding manufacturer in Montana, whose owner and management team collaborated with key partners over a five-year period to achieve the owner's financial and legacy goals.

PDM
PLASTIC DESIGN & MANUFACTURING

Plastic Design & Mfg Inc.

aka "Plastics Done by Mike"
PDM is an injection molding and tooling company serving the outdoor, hardware, communications and automotive markets, as well as government agencies like FEMA. Founded in 1998 by Mike Groff, the company has achieved strong and consistent growth, leading to the addition of a custom-built factory in Southwest Montana in 2009, and extended operations in both Mexico and Asia. The company now employs approximately 65 people in the small town of Manhattan, Montana, and more than 90 people in Juarez, Mexico.

Recognized as a leading manufacturer in the state, PDM was selected as "Manufacturer of the Year" by the Montana Chamber of Commerce in 2015, as well as Key Strategic Supplier for several Fortune 500 companies. For more than 20 years, Founder/President Mike Groff has led the company's growth and development, including a full-time, hands-on approach to managing daily operations, directing sales, and spearheading continuous improvement. He also demonstrated a strong commitment to generating economic benefits and career opportunities for his community.

TIME FOR A CHANGE

The Montana Manufacturing Extension Center (MMEC) had long enjoyed a successful partnership with PDM, and in 2016 was collaborating with the company on a broad range of projects, including ISO certification and Lean improvements. Groff was starting to think about the "third act" of his life and career, including how to transition out of a full-time role at PDM, as well as ownership. He and MMEC began to have conversations about how to prepare the company to be attractive to potential buyers, and most ready for a change of control.

Groff had several goals that would define a successful transition:

- Secure an optimal price that would reflect his time, work and investment into the company.
- Conduct the transition at the right time for him, with favorable terms and conditions.
- Prepare the company for continued success in Manhattan, Montana and Juarez, Mexico, providing well-paying jobs and economic growth for both communities.

FIRST STEPS, FIRST OFFER

Early on, Groff recognized that leading a successful transition would add significantly to his personal responsibilities and workload. How would he meet the twin mandates of fulfilling full-time duties as Company President, including sales leadership, and also allocating adequate time and attention to change of control activities? For assistance, PDM began building a team that would support Groff and the company throughout the transition. MMEC was retained to provide expert guidance in the transition process and to continue its operational improvement projects with PDM. In addition, Tom Walker of On the Rise Consulting was brought on to provide specialized financial assistance. Walker, a former SBDC Director, had extensive mergers and acquisitions (M&A) expertise and provided essential input at key decision points.

> "There's no Kelly Blue Book for manufacturers to use to estimate the potential value of their company. Don't underestimate the value of a well-rounded team that includes operations and finance professionals."
> Alistair Stewart, MMEC

As a starting point, the team began working on operational valuation, to determine:

- Current enterprise value
- Potential enterprise value
- Risks that threaten value
- Value creation levers that could be pulled to increase company value

Through this process, the economic value of the risks represented more than 30% of the company's enterprise value, a concerning level that needed to be addressed. The team identified the following risks as having a strong impact on the company's enterprise value:

- Undue reliance on the owner
- Customer concentration
- Lack of defined sales and marketing processes
- Strength and depth of management bench

By gaining clarity on these risk factors, Groff and MMEC were able to carve up the transition planning responsibilities while allowing Groff to focus on the day-to-day running of the business. The team began executing a series of de-risking activities, including improving financial gains to the top and bottom line, driving gains in workforce and talent capability and stability, customer development, and initial implementation of an industry-specific enterprise resource planning (ERP) system.

During this period, a potential buyer appeared, unsolicited. This event created additional tasks for the company, including more than three months of work to gather data and respond to diligence requests related to a potential purchase offer.

However, the recent valuation process proved beneficial as Groff was able to use this information to detail and articulate the tangible and intangible components of the company's value. During negotiations, this information brought to light the gap between the owner's target price and the buyer's perceived value. It became apparent that the potential buyer was only interested in purchasing tangible assets, rather than acquiring an entire business to operate on an ongoing basis (which was one of the owner's legacy goals). Ultimately, Groff decided that the purchaser was not a good fit, and no deal occurred.

ROUND 2: A RETURN TO DE-RISKING ACTIVITIES YIELDS POSITIVE AND UNEXPECTED RESULTS

Once a broken deal occurs – even if it's the right decision for the selling owner – it can become more difficult to attract subsequent buyers. They may perceive the company as less desirable and be more cautious of considering it for purchase. With this in mind, Groff and his team returned to the findings of the earlier operational valuation and risk assessment and re-energized their efforts to increase the value of the business. In particular, they focused on expanding the management bench to support Groff with additional capacity and specialized expertise. Three new positions were added:

- A Chief Financial Officer, to implement disciplined and data driven fiscal processes.
- A Vice President of Operations and Engineering position to develop the workforce through Lean and other transformational initiatives.
- Later, a Vice President of Sales and Marketing to strengthen customer development and initiate data-driven sales and marketing plans.

The transition team used several methods to find strong candidates for the new positions. MMEC assisted PDM in its search for a CFO, and introduced the successful candidate to the owner. For the VP of Operations and Engineering, PDM promoted from within, selecting the company's Engineering Manager who had extensive Lean experience from his previous position at Toyota.

> "Each decision a business owner makes, no matter how large or small, plays a role in determining tomorrow's value." Michael Benson, Managing Director of Investment Banking, Stout*
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> *Benson, Michael (2017). Nurturing Business Value in the Plastics Industry. Stout.com: https://www.stout.com/en/insights/article/sj17-nurturing-business-value-in-the-plastics-industry

Furthermore, PDM created an Advisory Board to leverage additional expert guidance and support for the transition. The Board included Scott Sehnert, a banker and President of the Montana Manufacturing Association; consultant Tom Walker; MMEC's Alistair Stewart; Gary Flattum, of Venture Plastics; and Matt Kerns, a long-time plastics materials/industry specialist.

With newly engaged leadership, PDM successfully implemented numerous improvements, including deployment of an effective Enterprise Resource Planning (ERP) system, improved Bill of Materials accuracy, installation of critical new injection molding machines, implementation of visual management on the production floor, and a strong focus on Overall Equipment Effectiveness (OEE), all of which improved quality and throughput. Sales and marketing improvements included development of a defined marketing plan to inform sales, and new processes for identifying and pursuing A-class customers and prospects, preparing accurate and profitable estimates, setting prices, and managing margins.

These successful initiatives were made possible through Groff's close collaboration with the new management bench. By recognizing where the company needed stronger capabilities (and not trying to lead all management activities on his own), Groff and his new executive team could combine their expertise to develop more comprehensive and focused approaches. As an example, Groff had led the sales function since the company was a small start-up, and initially had some reluctance in letting go of these responsibilities. The management team helped Groff see the potential of using a dedicated sales professional, targeted marketing techniques, client prioritization, and other strategies suited to the larger, more established company that PDM had become.

With the stronger management bench in place, Groff was able to transition out of his full-time role as President, even before the change of ownership took place. This allowed Groff to achieve one of his goals of scaling back his time at work, while also allowing the management bench to fully establish themselves as the company leadership in preparation for the change of control.

NEW BUYERS EMERGE – FROM WITHIN

These improvements also led to a key turning point in the transition process – the new leadership team expressed interest in a management buyout proposal. With their firsthand and in-depth knowledge of the recent changes, the team recognized the value of the improvements and could envision the company's high potential for future success.
A management buyout had several advantages. The leadership team understood the full value of the company, so the due

diligence process would be less complex. It also increased the likelihood that the buyers would follow through with the transition to completion. While outside buyers are more likely to pull out of a deal when challenges occur, internal buyers tend to be more personally committed to working through obstacles and seeing the deal through. Once Groff and his leadership team realized their mutual interest in the management buyout proposal, they stopped considering other transition options (such as sale to an outside investor, including to a competitor) and agreed to move forward with the internal proposal.

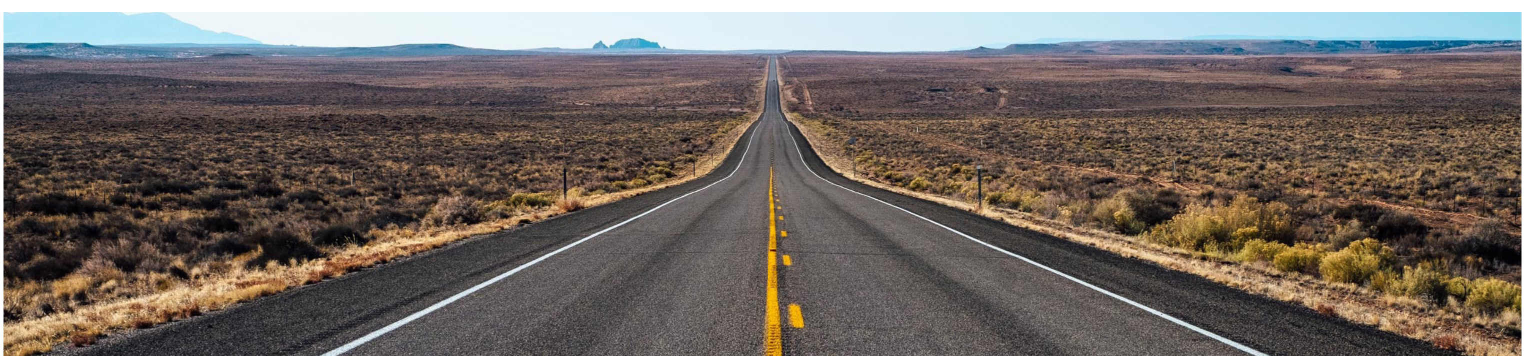
"Mike Groff and the entire PDM team have worked so hard over the years to build a successful company from the ground up, and now we are positioned to provide even more value to our customers and employees as we continue our transition to a well-established mid-sized manufacturer." Randy Scheid, PDM President/CFO

REACHING THE FINISH LINE

Even with existing relationships and in-depth knowledge of the company on both sides, a successful transition requires clear communication between the parties and detailed planning. Even though large components of the deal had been worked out, smaller details caused delays in the completion of the transition. In particular, there were a number of factors that affected the company sales price and financing arrangements until the very end. As an example, near the time when the transition deal was first scheduled to close, business conditions compelled PDM to purchase new manufacturing equipment and expand facilities. In the eyes of the bank financing the buyout, this impacted Groff's financial status, so the bank altered the terms of the financing. Groff also made the decision to fund the deal and allow for concessions that ultimately served the goal of maintaining the operations intact, in community, and with the right team.

At this point, financial consultant Tom Walker once again played a key role in helping the transition reach a successful completion. Thanks to Tom's close familiarity with the company's fiscal administration and resources, he was able to propose a deal structure that accommodated the new equipment and building issues and satisfied the interests of both buyers and sellers.

Ultimately, the transition was made possible due to the strong ongoing trust between all the partners, as well as a shared commitment to the brightest possible future for PDM. After nearly five years, the transition was finalized in December 2021.



WHAT WAS THE BOTTOM LINE IMPACT?

Between the time of the first unsuccessful purchase offer and the completed change of control, the Enterprise Value of PDM increased by more than 50%. This increase is attributable to the combined impact of the de-risking activities and operational improvements spearheaded by the transition team.

ACTIONABLE INSIGHTS FOR COMPANIES CONTEMPLATING A CHANGE OF CONTROL

It is essential for sellers to be as well-informed as possible prior to a change of control. Financial and strategic buyers will most likely have pursued and completed several prior deals, and that experience will provide them an advantage in the buying process. By contrast, sellers often don't have the knowledge or capabilities to lead an informed sale. Sellers should begin the process of assessing and documenting a company's value well in advance of entering into negotiations with potential buyers.

The seller must understand and mitigate the specific risks that threaten enterprise value. This will likely be uncomfortable for the owner, who will need trusted advisors to guide him or her through the discomfort and help maintain focus and momentum on de-risking initiatives.

A serious owner fully committed to a successful change of control does not have time to simultaneously be a full-time President/CEO and the person managing the transition. He or she needs a fully rounded team of expert advisors. Creating and leveraging that team brings capabilities that the owner doesn't have and frees up the owner to run his business. The investment in expert support pales in comparison to the opportunity cost of the owner's time and the potential to make very expensive unforced errors due to insufficient knowledge and experience.

As a company prepares for a potential transition by assessing its value, it is useful to create and use tools that characterize the tangible and intangible components of the company's enterprise value and are available for meetings and presentations. Examples include a professionally built teaser, pitch deck, and audited financials.

A robust CRM is needed to inform a company's sales & marketing processes and to capture key contacts and institutional knowledge from the departing owner prior to transition. Reducing the company's reliance on the owner for key customer (and other) relationships is critical. Having robust customer and sales data enables fresh eyes to more effectively evaluate customer/contract profitability. Capturing this information in a CRM prior to a transition creates a valuable resource. The same applies to an ERP for other business functions. PDM offers the following lessons learned regarding implementing an ERP.

Take time to choose the right ERP, and work with the right implementation partner who has a track of success in comparable companies, and who will configure and deploy the solution such that it supports operational excellence.

Data quality is key to success. Ensure and enhance data quality before you input data into the system.

For maximum benefit, a new or upgraded ERP or CRM should be fully implemented at least 12 to 24 months prior to a change of control.

Irrespective of who is in the universe of potential buyers, a strong management bench that's excited to continue to drive the company's growth creates value. Strengthening the bench prior to a transition provides opportunities for the team to establish its leadership within the company and demonstrate its capabilities to prospective buyers.

If possible, avoid making major capital investments during the final stages of a major transition. It may well affect the terms of a proposed deal (such as a lender's assessment of the seller's financial standing and available resources), resulting in delays.

ABOUT THE AUTHOR

ALISTAIR STEWART is a Senior Business Advisor with the Montana Manufacturing Extension Center. He has attained the nationally recognized Certified Exit Planning Advisor credential and much of his professional career has been spent guiding the owners of small and medium-sized manufacturers to clarify what success means, and helping them achieve it.