

MEASURING UP: USING INDUSTRY- AND REGION-SPECIFIC BENCHMARKING STUDIES TO DRIVE DOWN COSTS AND IMPROVE BUSINESS VALUE

Private equity funds can present portfolio companies with a wealth of industry-specific knowledge from sources that include internal fund operating professionals, other related companies in the fund's portfolio, and access to third-party industry experts. One valuable tool that can be generated from this cross-functional knowledge sharing is benchmarking—that is, comparing the company's own costs to its most relevant competitors' costs.

Benchmarking is a tool that has proven to be incredibly useful for one key industry segment: apparel. In this environment, apparel companies are limited in their ability to improve profitability through increased sales or higher prices, forcing them to drive down costs and operate as efficiently as possible. By measuring their own overhead against that of their direct competition, apparel companies can identify areas where they can better control costs and increase profits.

Benchmarking offers a way to see if the prices for basic needs, such as warehousing, are still the best the company can get, using actual industry data as a metric. Perhaps more importantly is that benchmarking has the potential to improve profits without a corresponding sacrifice in other areas of the business. By identifying inefficiencies, benchmarking exposes the low-hanging fruit—the areas where money spent has little effect on quality. That removes the need to reduce costs in areas that will hurt the company's brand, such as staff and

operations, and, ultimately, its value to lenders and investors.

To be effective, benchmarking studies need to be highly specific and built upon

a multitude of areas and line items where costs can vary substantially on an ongoing basis, so data from prior transactions and due diligence investigations can quickly become dated.

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data from a group of direct competitors—not just apparel companies, but apparel companies selling the same products, in the same market subsegment, to the same types of retailers, in the same geography.

Leverage Your Professionals

In this regard, apparel companies, private equity firms, and management who are working to improve their operations and profitability face a special challenge in conducting a benchmarking study. Because the vast majority of apparel manufacturers are privately held, there's little useful public information on costs, certainly not at a line-item level. By and large, the information needed is simply not available for apparel companies to undertake benchmarking on their own. Private equity firms that are substantially invested in the apparel industry will have a somewhat broader range of data and experience available to them, but this will largely be limited to what data they presently hold in their portfolio. Moreover, a comprehensive benchmarking study involves looking at

This is one area where companies can get added value from their existing relationships with their accounting and consulting professionals. Firms that have a dedicated practice serving the apparel industry spend a great deal of time researching and analyzing fashion and apparel companies across a broad range of subsegments and market tiers. As a result, they often have the experience and deep industry knowledge to conduct a comprehensive benchmarking study. Since these professionals have a pooled database of benchmarking information, they can inform apparel companies and their investors where costs are above average for their specific part of the market and provide strategies for bringing such costs in line without sacrificing the confidentiality of their other clients.

Understanding where there are potential cost reductions and moving quickly to pursue them is key for apparel companies looking to make themselves more attractive to their lenders in this tight credit market. Private equity firms can use these detailed

benchmarking studies to help identify the best investment opportunities as part of their due diligence or to improve the performance of companies already in their portfolio.

Case Study: Shipping and Warehousing Inefficiencies

Recently, J.H. Cohn's Apparel and Fashion Industry Practice worked through a benchmarking study with an apparel client based in New York City. J.H. Cohn's benchmarking study uncovered a number of areas where we worked with the client to provide guidance on the renegotiation of their vendor contracts but, most importantly, helped them achieve significant savings in their shipping and warehousing costs, some of the largest line items on their income statement.

The company was having their product manufactured in China and shipping it via air to warehouses in northern New Jersey, where they had long maintained their warehousing and distribution operations. This warehouse was a holdover from a previous phase of the company's growth—while it was within easy striking distance of the company's office, it was identified as operationally inefficient by benchmarking studies. The warehousing costs themselves weren't

singled out as abnormally high in the study, but we did uncover that cost of shipping was substantially above that of their direct competitors, since they were flying in the inventory.

J.H. Cohn worked with the client to switch to a warehouse and distribution center on the West Coast, which allowed for more efficient, lower-cost distribution within the U.S. while allowing them to avail themselves of the alternative of surface shipping at substantial savings. In balance, delivery time was only marginally impacted and was more than offset by the substantial cost savings – a cost reduction that had no negative impact on product quality and didn't negatively affect relationships with retailers. This strategy required an increased capital outlay in the short term, but the cost savings in shipping charges were realized immediately—savings that will be realized on an ongoing basis.

As in the above example, benchmarking studies can lead to changing the way a company operates.

If the same New York-based apparel company habitually turns around its inventories quickly, it can achieve a high volume of business and keep cash flowing in. However, because it needs its products

to reach the United States quickly, it must ship by airplane—ensuring that shipping prices stay high. In fact, some companies become trapped by this situation, unable to afford to convert to boat shipping without an infusion of new capital. A new investment could have a dramatic and immediate positive effect on the profits of such a company.

Gain, No Pain

Cutting costs is always a good idea, but when times are tough, it's an essential strategy to evaluate costs for both businesses and their investors. Benchmarking offers an opportunity to identify where those savings can be had and reduce costs without trading down or unnecessarily sacrificing quality or brand cachet that many companies have worked hard and invested substantially in building. The financial savings can also free up capital that businesses badly need in the current credit market. Working with knowledgeable professionals who are deeply involved in a specific industry can help increase profitability, generate value for investment partners, and identify other attractive opportunities. ■

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WHY WOULD ANYONE WANT TO BE THE “STALKING HORSE BIDDER” IN A SECTION 363 TRANSACTION?

The current economic environment has created significant opportunities for private equity funds and other prospective buyers to purchase assets from a company in bankruptcy (the “Debtor”) out of the ordinary course of business pursuant to Section 363 of the U.S. Bankruptcy Code (“Section 363”). The goal of a Section 363 sale is to obtain the highest and best offer for the assets being offered for sale through an auction process.

In a typical Section 363 transaction, the Debtor, together with its financial and

legal advisors, negotiates with the Stalking Horse bidder (“SH”) to enter into an asset purchase agreement which serves as the floor against which other bids are made at the auction. The SH is rewarded, through a break-up fee and expense reimbursement, for investing the effort and expense to enter into a transaction that will be exposed to “higher and better” bids.

Several Advantages of a Section 363 Process

Perhaps the greatest benefit of purchasing assets through a Section 363 process is that

the buyer can acquire them free and clear of liens and most claims, except for possible successor liability for product liability and employment and environmental claims against the Debtor. Other key benefits include:

- Anti-assignment provisions contained in Debtor's contracts are generally mooted, thus contracts can typically be sold and assigned without third-party consent;
- Majority shareholder approval not required;
- Court approval required—little risk of appeal; and

- No fraudulent conveyance issues as the Section 363 process ensures that the best offer for the assets to be sold has been obtained.

Of course, there are certain drawbacks as well, including the open fishbowl nature of the court-supervised process whereby the terms of the transaction are public through bankruptcy court filings. In addition, court uncertainty could delay the process, and the sales process must be shopped to ensure that the highest and best price is obtained for the assets sold.

The SH is often the first player to demonstrate interest in the sales process. As it finalizes its bid, the SH is awarded the opportunity to perform extensive due diligence. This frequently allows the SH to have a deeper understanding of the risks and opportunities associated with the acquired business. The SH can use this deeper knowledge to structure a contract that is more difficult for a competing bidder to step into.

The SH has the advantage of being able to dictate the commercial terms of the

enhanced the sale process and prospects. Accordingly, the typical sales contract will provide for a break-up fee to reward and repay the SH for its role in commencing the sales process and related auction, as well as for reimbursement of due diligence costs, professional fees, and investments of time that have been made. Such a fee typically approximates one percent to five percent of the purchase price. The terms and timing of how these items will be paid to the SH are often as important to the SH as are the dollar economies of the deal.

The advice of experienced professionals is essential to ensure that the process moves forward and is done correctly. The process is meant to balance the unavoidable conflict between a buyer's desire to obtain the best price and the seller's desire to get maximum value.

It's Good to Be the Stalking Horse

As described above, the Section 363 sales process frequently includes a SH, selected by the Debtor in an arm's-length negotiation. While descriptive, the use of the term is not a particularly appropriate use of the phrase. The dictionary defines "Stalking Horse" as one that acts as a screen or image behind which a hunter would hide and stalk his prey. In a Section 363 process, the actions of the SH are hidden from no one and visible to all. The benefits of being the SH include the following:

- The opportunity to perform extensive due diligence;
- A commitment to a price that forms the floor of the subsequent action;
- The opportunity to develop strategic relationships with the Debtor and the professionals involved in the bankruptcy;
- Negotiation of deal terms that are most beneficial to the SH, including some form of exclusivity period;
- Negotiation and execution of a form of contract for the transaction that best suits the SH's needs, including competing bidder qualifications and minimum overbid amounts; and
- Ability to influence the economies of the deal including expense reimbursement and break-up fees.

transaction. As such, the SH has the ability to manage the risk associated with its bid—thereby maximizing the cash component of the bid and minimizing the debt component. These terms will be looked upon by the Debtor and other constituents in the bankruptcy as favorable—and will make it more difficult for another bidder to come up with a bid that is "higher and better." As the SH should be further along in the due diligence process than other bidders, certain known information can provide the SH with an opportunity to accept terms that competing bidders might blanch at. For example, if a prospective SH gains sufficient knowledge of the inventory to realize that a plus or minus in inventory quantities will not cause a material swing in value, then the SH could accept a deal with little or no representations or warranties with regard to the existence of inventory.

SH Protections and Rewards

The economic protections afforded to a SH bidder are meant to induce the SH to spend enough time and effort to formulate a bid that will set a floor for the sale of the assets. It is also assumed that the diligence efforts incurred have

Finally, we note that the SH can attempt to leverage its influence over timing and bidding procedures. Most will push for the fastest possible timeline using the "melting ice cube" analogy. The less time competitors have, the more durable and useful the SH's acquired knowledge becomes.

J.H. Cohn Can Help

As outlined above, the benefits to being the SH bidder in the purchase of a business or group of assets can be significant. Some savvy experienced buyers of distressed assets will not, by policy, participate in a Section 363 auction unless they are the SH. It is worth noting that the process described above is not dictated by the Bankruptcy Code, but rather has emerged by cumulative practice, some of it local. The advice of experienced professionals is essential to ensure that the process moves forward and is done correctly. The process is meant to balance the unavoidable conflict between a buyer's desire to obtain the best price and the seller's desire to get maximum value. J.H. Cohn's professionals stand ready to assist you in considering, pursuing, or capturing a business opportunity by buying assets pursuant to Section 363. ■

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A MISSION CRITICAL TOOL FOR PRIVATE EQUITY

Portfolio Company Reporting System (PCRS)

Decisive action takes confidence, and confidence comes from knowing that you have immediate access to high-quality data delivered where, when, and how you need it.

For more than 35 years, helping clients find and implement the right tools to improve performance, while enabling them to measure, monitor, and track key processes, have been hallmarks of J.H. Cohn LLP's Performance Consulting Services team. In conjunction with the Firm's Private Equity Services Practice, we now offer a business intelligence tool from iLevel Solutions designed to help private equity firms manage their portfolio's financial and operational Performance.

iLevel's flagship product, the Portfolio Company Reporting System (PCRS), is a completely integrated solution enabling private equity firms to gauge the financial health of the companies in their portfolios. PCRS was originally developed to manage

Industry Pain (Alternative Investment Managers)	
<ul style="list-style-type: none"> More demanding LPs and more frequent requests for data 	<ul style="list-style-type: none"> Self-service LP portal improves customer service
<ul style="list-style-type: none"> Lack of data accountability 	<ul style="list-style-type: none"> Proper audit mechanisms and centralized data results in accountability and high data integrity
<ul style="list-style-type: none"> Need to drive down costs & increase operating efficiencies 	<ul style="list-style-type: none"> Faster, more efficient data collection, analysis, and reporting
<ul style="list-style-type: none"> Costly audit process 	<ul style="list-style-type: none"> Enhanced data integrity and auditability of data reduces 3rd party audit costs
<ul style="list-style-type: none"> Limited transparency (GP & LP) 	<ul style="list-style-type: none"> Portal access provides transparency
<ul style="list-style-type: none"> Manual processing of spreadsheets is costly, inefficient, and error prone 	<ul style="list-style-type: none"> Systematic process results in efficiency and cost reduction with streamlined processes
<ul style="list-style-type: none"> Lack of formal workflow or collaboration makes data entry and approval a difficult process and effects data integrity 	<ul style="list-style-type: none"> Workflow and collaboration is automated with alerts, approvals, and self-maintaining portals
<ul style="list-style-type: none"> Lack of consistent reporting methodology across the various portfolio companies makes data consolidation tenuous 	<ul style="list-style-type: none"> Configurable dashboards and database-driven excel integration deliver comprehensive analysis and reporting
<ul style="list-style-type: none"> No data warehousing 	<ul style="list-style-type: none"> Data is centralized (one central source)

is timely, accurate, and consistent. PCRS simplifies the collection, storage, analysis, and reporting of the financial and operational metrics of portfolio companies and enables business leaders to identify trends, run

Collaborative Business Intelligence—From Collection to Analysis

The benefits of iLevel Solutions' PCRS tool include:

- Sophisticated, flexible dashboards with drill-down capabilities that allow anywhere, anytime access to time-sensitive portfolio data.
- Customized alerts with timely detection and immediate notification of portfolio company performance issues requiring attention.
- Focus of analysts and deal team members shifts from data collection to reporting, analysis, trending, risk mitigation, and investigating new opportunities.
- A streamlined workflow process increasing data integrity and auditability—instead of the “spreadsheet shuffle.”
- Highly secure Software-as-a-Service (SaaS) delivery model that requires no capital expense for infrastructure or additional technical staff.

Whether identifying trends through company data, compiling valuation information for investors, or taking advantage of Excel-based financial dashboards on-demand, you can be confident that the information you receive is timely, accurate, and consistent.

the complex reporting needs of a large, global private equity firm. Today, the system is used to monitor and assess hundreds of portfolio companies. Although designed to handle the complexities of top tier firms, the scalable architecture, flexibility of the reporting capabilities and ease of installation and use make PCRS an ideal tool for private equity firms of all sizes.

Whether identifying trends through company data, compiling valuation information for investors, or taking advantage of Excel-based financial dashboards on-demand, you can be confident that the information you receive

‘what if’ scenarios, perform portfolio modeling, and compile valuation information for their limited partners and investors. Data is organized and standardized, enabling accurate comparisons across companies and industries to be easily reviewed from the same perspective. ■

For a personal demonstration of the Portfolio Company Reporting System, please contact Steven Pinsky, CM&AA, principal and Private Equity Services Practice Director, at spinsky@jhcobn.com or 877-704-3500.

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BUSINESS INTELLIGENCE FOR PRIVATE EQUITY FIRMS



For more information on J.H. Cohn's Private Equity Industry Practice, [click here.](#)

J.H. Cohn's Private Equity Services Practice invites you to join us for a one-hour webcast where we will explore and demonstrate the Portfolio Company Reporting System (PCRS) from iLevel Solutions. Click on the links to register for either of two sessions:

Tuesday, October 27, 2009 from 12:00 p.m. to 1:00 p.m. EDT

Friday, November 20, 2009 from 9:00 a.m. to 10:00 a.m. EST

During this webcast, we will demonstrate how PCRS can improve customer service, data integrity, data collection and analysis and much more. With PCRS, collaborative business intelligence is delivered on demand.

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