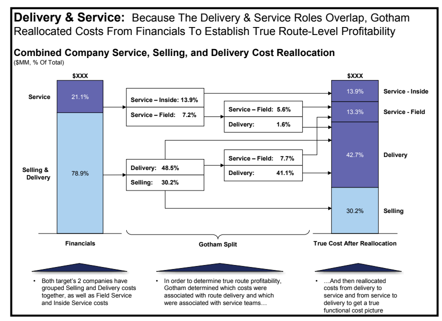
Operational Due Diligence Of Family-Owned Coffee Distributor: Identifying Consolidation Opportunities & Creating Roadmap To Professionalize Operations

The Challenge: One of Gotham's long-time PE clients was in advanced negotiations to acquire a regional family-owned coffee roaster and distributor, servicing the convenience store, office, and foodservice channels. The target, which had grown rapidly over the last several years through expansion in the convenience store channel, consisted of 2 separate businesses both owned by the same family, yet run as completely separate organizations. Our client felt that significant operations improvement opportunities existed but was stymied by the lack of any meaningful operational and cost performance information. Our client asked Gotham to conduct a 3-week operational due diligence to confirm the opportunities and provide a fact-based, actionable roadmap for post-acquisition value creation by professionalizing operations and/or capturing consolidation opportunities in: (1) delivery and service network; (2) sales force effectiveness; (3) brewing equipment CapEx; (4) supply chain processes; and (5) roasting operations.

Operational Roadmap To Consolidate And Professionalize Operations: As the target had no true ERP system and only very basic Excel reporting, Gotham had to take several different approaches to generate relevant operational and financial facts: scraping data from original sources; observing operations first-hand; mapping core processes; and interviewing management and key operations personnels. By analyzing/triangulating collected data, Gotham established a solid fact base of cost and operational performance: delivery and service route profitability; salesforce effectiveness; brewing equipment CapEx; sales and SKU complexity; inventory; sourcing efficiency; warehouse costs and capacity utilization; and roasting operations efficiency.

Overlap In Delivery And Service Route Coverage; Opportunity To Eliminate 30-40% Of Delivery Routes

Faced with no meaningful facts on the target's routes and muddled/top-level financials, Gotham took a bottom-up approach to generate an actionable understanding of delivery and service route network. First, we analyzed a full year of transaction-level data (GPS data for each truck, customer invoices) to piece together current route structure and establish key metrics (e.g., miles, number of stops, drive time, delivery frequency). We then reallocated cost information from the target's financials into proper operational cost buckets using organization chart, payroll data, and our bottom-up understanding of the route network. This allowed us to create a detailed route-level view of financial performance, including route cost breakdown, cost per stop, customer profitability, etc. Using the performance data and based on a full understanding of the route network, Gotham identified a route optimization opportunity to eliminate 30-40% of target's 75+ routes and an organizational restructuring opportunity to reduce headcount.



Significant Brewing Equipment CapEx Reduction Opportunity Without Compromising Target's Sales Strategy

Our interviews with key management and sales personnel indicated that target's premium positioning is supported by its sales strategy of providing brewing equipment at no cost and maintaining a highly-interactive relationship with its customers. In support of this value proposition, the target was spending close to $3MM in brewing equipment CapEx. Gotham analyzed the target's brewing equipment asset list at the equipment level and reconciled it against operational data to develop a profile of brewing equipment by type and by channel. We then reviewed target's current deployment approach by analyzing the payback period of target's deployed assets and the percentage of new (vs. used) assets, including equipment in the field and under repair. We then modeled CapEx options by contrasting the economics of buying new equipment vs. that of repairing old equipment, including staffing, cost, and repair time. We established that target could reduce its CapEx spending by up to 30% through better repair policies.

While "Getting The Job Done" At Current Volumes, Target's Supply Chain Requires Professionalization To Support Growth

In addition to building a fact base on supply chain performance, we developed a supply chain end-vision, detailing near- and longer-term solutions. We found that target's supply chain lacks necessary systems and processes in the following areas:

- **Inventory:** Unsophisticated SKU management practices and lack of inventory controls leading to proliferation of SKUs (e.g., blends, colors, grinds, flavors) and high inventory levels
- **Purchasing:** Spend managed by numerous people, with limited coordination between target's 2 companies resulting in various inefficiencies (e.g., different vendors used for same commodities, limited pooling of volumes to negotiate prices)
- **Warehousing:** Inefficient layouts and independent operations at target's locations resulting in unnecessary touches and excess costs; Gotham developed 3 options to combine central warehouse operations.

Target's Roasting Operations Run Smoothly With Some Opportunities To Mitigate Risks And Systemize Operations

Based on initial review of target's roasting operations, Gotham did not expect to find significant opportunities. To validate our ingoing assumption and asses potential risks, we conducted a top-level assessment which revealed: 1) well-run manufacturing operations, with adequate capacity for current production, and aging equipment in good condition; 2) potential risk in production planning as only two people knowledgeable of the processes and homegrown Excel planning tool; 3) adequate food safety/quality processes; and 4) opportunity to professionalize operations management via proper systems (e.g., MRP) and KPI reporting.

The Outcome: Our client moved forward with confidence from Gotham's due diligence findings, including our identified savings opportunity of 3-4x management's estimate. Within a few weeks of deal closure, the company had initiatied capture of identified opportunities: 1) eliminated 7 delivery routes with 20+ additional routes planned for elimination over the following weeks; 2) reduced delivery and service headcount by 7; 3) reduced coffee inventory; and 4) began using IT systems for managing inventory.

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