



Interview with
Jim McHugh

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Editor's Comments: In the M&A business, companies are frequently sold prematurely or too late to achieve maximum shareholder value. In many of these situations, even though the companies are profitable (barely) and growing (hardly) and achieving a return on investment (marginally), they are STUCK...showing hardly any improvement year after year. McHugh & Company specializes in fixing companies that are stuck, either: 1) private businesses/family-owned companies; 2) portfolio companies of private equity funds; 3) divisions of large, multinational companies. The following article encompasses an interview with Jim McHugh, age 53, who explains how his firm has the unique capability to provide strategic, operational and financial consulting services to vastly improve their clients' future value.

What differentiates McHugh & Company from its peers?

I like to say "WE FIX COMPANIES THAT ARE STUCK!"

What do you mean by "stuck"? Isn't that just another way to describe a turnaround or workout situation? Not really. Being stuck means some part of the company is a little off-kilter. This does not necessarily imply that the company is in a turnaround or workout mode. Even though many stuck companies are in relatively decent shape, we have seen some of these common characteristics:

- Sales, margins and profits may be flat or declining. "We have a cost problem" is a familiar refrain. There are excessive costs that are hard to eliminate (it's like a rising tide at the beach; the water is all around your feet before you realize it).
- Shareholder value is being eroded even though the owners/managers are receiving very healthy compensation.
- Either the organization is working harder than necessary ("corporate high blood pressure") or, the organization is hardly working (no sense of urgency).



Jim McHugh

Typically, the slide into a stuck mode is more insidious than a quick turnaround crisis caused by an unforeseen circumstance such as a drastic change in the customer base or a significant quality problem. Getting stuck develops more subtly over a long period of time.

Strong emotions or being too close to a situation can make it hard for management to recognize *the specific issues that need to be systematically and collectively addressed*. When we ask: "Have the current strategies caused the company to achieve superior competitiveness and an increased shareholder value?" The answer is generally "No".

This lack of direction can be frustrating to both the shareholders and management. When that happens, McHugh & Company is called in to be a "fresh pair of eyes" to the company. We easily cut through clutter, figure out why the company may be bogged down, and create new, realistic initiatives.

What contributes to a successful consulting project?

The first and most important ingredient for success is for the three key constituencies — the Board, Shareholders, and Management — to admit that the company is stuck. After they wave the white STUCK flag, we show up in the lobby! In some private

continues on page 2

FIXING COMPANIES THAT ARE STUCK

continued from page 1

companies, all three of these are the same people; in other companies the majority shareholders may be outside private equity groups or a corporate parent. If there happens to be a difference of opinion with the various groups, that often makes our consulting work more challenging in the early stages of the project.



What is your approach with a client?

To simplify the process! We diagnose what's going on to *make complicated situations understandable to all parties* and then move to get the place unstuck. We can unravel disjointed, intricate data and conditions and pull out the nuggets that are invaluable in establishing the buy-in between management and shareholders. Our approach has been crafted from the experience of seeing many stuck situations and is:

- down to earth – we engage people in a non-threatening style
- analytical - fact-based and data driven
- communicative – listen, listen, then respond
- creative – we love to think and problem solve
- comprehensive – never leave a stone unturned
- optimistic – we offer hope and deliver results

How do you structure a diagnostic review of the business?

We have a passion for classic business strategy and have tailored a simple, strategic assessment model that seems to work very well with the management of mid-market companies. The assessment is based upon traditional analysis. However, we craft a holistic look at how strategic, operational and financial issues are impacting the performance of the business. The deliverables to our client are the key action steps needed to revitalize the company.

McHugh's six key components used to diagnose a stuck company

Assess the Industry Attractiveness (Stuck in Another World) Many industries are changing significantly, radically and quickly; others have shifting dynamics that are more subtle. In either case, we want to know the overall structure and trends and understand where the company currently fits. We look critically at whether this is an industry that should support continued investment. Some typical factors that we have seen that can freeze a company are: a) customers demanding technological changes that require substantial investments in physical plant or processes, b) The China Factor, c) industry overcapacity.

Identify the Sources of Competitive Advantage (Stuck in the Past) A Partner of a Private Equity Group once told me that he tries to look beyond a company's warts to determine the "pockets of strength" (at the time I

was assisting a company that didn't have very many, so our conversation was pretty brief!). In short, we look at:

- What are the underlying capabilities, core technologies and core competencies of the company? How can these be capitalized on to fuel future growth? Have once superior technologies or products become commodity-like?
- Are there inferior operational practices (e.g. unwieldy, outdated bills of material or inconsistent/weak business processes) that negatively impact the daily operations?

Understand the 'Business Definition' (Stuck in the Middle) We use the simple 80/20 rule on every engagement to assess the complexity of a business. For example, a weak strategic focus can create a muddled combination of operating entities, customers and products. The poor business definition can worsen if inefficient operational conditions, weak management practices and negative industry forces are present. We believe the guts of an 80/20 analysis is really about simplifying and focusing on the key parts of the business; action on simplifying inventory items, bills of material, customers, suppliers, etc. can reduce costs and get a company unstuck.

Evaluate the Competitive Position (Stuck in Traffic)

A company's overall competitive position is based on its posture with competitors and from its relationships with customers and suppliers. Being ineffective or non-responsive to customers, suppliers or competitors can definitely cause a company to become stuck. We have seen many situations where a company should 'fire' individual or groups of customers because they have a) become unprofitable, b) put unreasonable demands on the business, c) are part of a dying segment of the industry.

Determine the Financial Condition (Stuck in the Mud) This seems obvious, but the lack of aggressiveness (laziness, sloppiness, ignorance) around pricing, gross margins, working capital and spending can cause a company to be endlessly slopping around in their own mud. The financials can be producing "comfortable" results, but being comfortable may not be enough to generate profits or cash needed to fund initiatives to improve the competitive position, introduce new products, shore up the plant with necessary capital expenditures, etc.

Evaluate the Management Team and Organization (Stuck in the Moment) An anonymous quote, "You can't change the past, but you can ruin the present by worrying about the future" reflects the state of mind and attitude of stuck management teams. Basically, we've seen companies get and stay stuck from a) management inaction, b) no strategic outlook, and c) too many "sacred cows."

continues on page 3

FIXING COMPANIES THAT ARE STUCK

continued from page 2

Various Success Stories

The following examples are some of McHugh & Company's projects based on the various conditions cited above.

Type	Stuck in the Middle
Quick Facts	\$65 million manufacturer of paper goods ("PaperCo") with 3 plants and 2 divisions. Family-owned, third generation.
Challenges	PaperCo had a number of interrelated issues: <ul style="list-style-type: none"> • limited growth and marginal profits over a number of years • one product line with 3000 customers representing only 10% of the sales • conflicting family opinions about long-term direction and focus
Resolution	Our work with PaperCo enabled them to: <ul style="list-style-type: none"> • divest the non-core product line that contributed to the manufacturing bottlenecks (sale was for one-time annual sales) and invest proceeds in needed capital assets • consolidate manufacturing locations • eliminate significant costs; dramatic growth in EBITDA

Type	Stuck in the Past
Quick Facts	\$10 million manufacturer ("MetalCo") of patented metal composites for tile and trim applications in commercial, residential and specialty retail design.
Challenges	MetalCo's patented metal composites were originally used to manufacture specialty retail and point of purchase displays. While this was a creative use of the company's technology, the custom, "job shop," direct sales nature of the business model restricted revenue growth and shareholder value. MetalCo needed a new product direction.
Resolution	Our work with MetalCo enabled them to: <ul style="list-style-type: none"> • target new markets that were a fit for MetalCo's technology • change the overall business model by entering into key joint venture marketing and distribution relationships

Type	Stuck in the Mud
Quick Facts	\$50 million manufacturer of aluminum windows ("WindowCo") with one plant that supplied 12 regional warehouse/distribution centers. Majority owned by two private equity groups.
Challenges	As the company grew, its operational processes, manufacturing operations, inventory controls and the overall management of working capital did not keep pace. The combination of too much complexity and poor controls created a cash crunch for the business.
Resolution	Our work with WindowCo enabled them to: <ul style="list-style-type: none"> • flush the excess inventory out of each branch location • create and enforce order rules to restrict the buildup of excess inventory • overhaul product engineering to tighten up bills of material by using more common parts and subassemblies • emphasize quality and change the culture: expand employees' thinking to include material handling/damage, detailed manufacturing, scrap • rationalize the entire product line: drop outmoded products and accelerate the development of new windows to meet market needs

Type	Stuck in Traffic
Quick Facts	\$20 million niche printer ("PrintCo") - One of five separate business units within an integrated journal, book, and magazine printing company.
Challenges	As part of a planned expansion/modernization program, the company moved to a new production facility equipped with new state-of-the-art presses. Soon after the move, PrintCo began to lose over \$100,000 per month. How could this happen?
Resolution	Our work with PrintCo enabled them to realize that the decline in profitability came from a number of interrelated issues. <ul style="list-style-type: none"> • the existing customer base had a number of money losing contracts and customers who put excessive and inappropriate demands on the plant; these clogged the front end and contributed to scheduling delays and bottlenecks • the quoting process used to price jobs was antiquated • an accurate job cost system did not exist

FIXING COMPANIES THAT ARE STUCK

Conclusions

Almost all companies become stuck at one time or another including industry icon IBM during the early 1990s. Unfortunately, many companies that are stuck do not realize they are in this situation, or if they do recognize their predicament, they do not know how to become unstuck. McHugh & Company is in the unique position of addressing strategic, operational and financial issues in the same assignment... enabling companies to start growing and building value again.

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