Vulcanite Case Study

Transaction background

Allegro Funds acquired Vulcanite Pty Ltd (‘Vulcanite’), a manufacturer of engineered rubber products, via a Management Buyout in September 2011. Vulcanite was one of four subsidiaries of Chess Industries, an Australian engineering group.

About Vulcanite

Australian-based Vulcanite designs and manufactures rubber-to-metal anti-vibration products used in a range of industry sectors including rail, construction, industrial and marine.

At the time of acquisition, Vulcanite employed 24 staff in Australia along with overseas sales contractors to assist in foreign markets.

Vulcanite was a non-core subsidiary of a larger diversified engineering group, Chess Industries. Vulcanite’s cash profits were being extracted to service group debts, resulting in minimal re-investment in the business. Growth stagnated, revenues declined 22% in the two years prior to Allegro’s ownership and rising local manufacturing costs and overseas competition were hurting the business. In response to these challenges, Vulcanite outsourced more of its manufacturing to low cost producers in Asia. While EBITDA margins improved, the increased offshore outsourcing resulted in quality issues, excess capacity and a deteriorating facility in Western Sydney.

Poor financial management also meant that Vulcanite had incurred FX losses on its overseas sales activity, which in many ways epitomised the company’s lack of focus and oversight.

It was against this backdrop of declining revenue, product quality issues, poor customer management and underinvestment that Allegro stepped in.

Turnaround program

Extracting Vulcanite from Chess Industries meant there were immediate turnaround initiatives we could implement to ensure the business received the necessary focus to prosper.
This included establishing an appropriate corporate governance framework and board of directors to oversee business operations. We also established new banking facilities that supported the business and allowed for reinvestment, rather than utilising profits to service group debt as was the case previously.

We strengthened the management team, including replacing the CEO and CFO. The senior executives co-invested in the business and we introduced other financial incentives to align management and shareholder interests.

To address the departure of key sales personnel we established an international sales team, hiring new employees based in the United States and Europe. A stronger sales presence with deep industry knowledge in key overseas markets enabled Vulcanite to drive more sales as well as provide more technical support to customers. This led to a strong improvement in relationships with recurring blue-chip customers. Vulcanite experienced a 115% increase over our investment period.

We also adopted a more strategic approach to offshore outsourcing, which under previous ownership had been used to drive down costs but had come at the expense of quality control. Instead we invested in a wholly-owned state of the art manufacturing facility in Malaysia, overcoming the reliance on lower quality outsourced providers. This allowed Australian operations to refocus on design and innovation, quality control and short run production. Collectively, this resulted in a further 12% improvement in margins, enhanced quality control and the capability to compete in previously inaccessible low cost markets.

The turnaround program delivered a significant improvement in Vulcanite’s financial performance with underlying EBITDA greatly improved, positive cash flows and an eight-fold increase in net tangible assets (NTA); supported by a growing order book and sales pipeline.

**Exit**

In July 2016, we sold Vulcanite to a subsidiary of German multi-national Continental AG, a leading global producer of rubber products.

Despite a severe market downturn in 2014, our turnaround methodology drove operational improvements and sales growth, delivering a strong return to Allegro investors.

In 2016, Allegro was awarded “Small Company Turnaround of the Year” for Vulcanite from the Turnaround Management Association (TMA).