

Customer & Market Due Diligence Of Test & Measurement Equipment Distributor: Assessing Channel Risks And Validating Growth Potential In Niche Specialty Distribution Market

The Challenge: One of Gotham's PE clients was participating in an auction of a technical test & measurement (T&M) equipment distributor serving a wide range of end-markets, including aerospace/defense, wireless/communications, and industrial. The target had experienced impressive growth over the last 2 years, capitalizing on post-recession recovery and an industry-wide shift towards indirect channel. However, given the degree to which the recovery and channel shift had already taken place, our client was questioning whether continued growth was feasible and, if so, how well positioned the target was to capture this growth. Furthermore, our client was concerned about the target's high level of OEM concentration and the target's limited presence in the rental market. To rapidly address our client's concerns, Gotham conducted a 2-phased OEM, customer, and market due diligence, beginning with a 1-week Phase I ahead of the final round bid, followed by a 3-week Phase II effort after the auction win.

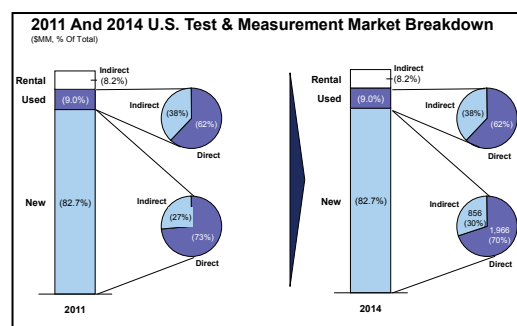
Niche T&M Equipment Distribution Market Assessment: To validate the market and OEM growth outlook, pin down the direct vs. indirect channel dynamics, establish the target's competitive positioning, evaluate rental business opportunity, and explore adjacent market expansion opportunities, Gotham undertook multi-pronged research and modeling. More specifically, we conducted 50+ interviews with customers, OEMs, and industry experts, profiled the major competitors and industry OEMs, analyzed the economics of the rental business, and undertook a comprehensive market size/growth analysis.

OEMs Remain Committed To Shift Toward Indirect Channel, Presenting An Opportunity For Strong Continued Growth

- **During Phase I**, Gotham, utilizing company data and publically available information, triangulated and validated the market size and growing indirect channel share, calculating a significantly higher 8+% 3-year CAGR for the indirect channel vs. a 2% CAGR for the direct channel. The continued shift to the indirect channel was further confirmed through interviews with key OEM executives in sales and management, along with several key customer decision-makers. Gotham concluded that the target should continue to benefit from this channel shift, given its strong existing relationships with leading OEMs.

- **In Phase II**, Gotham assessed the risks associated with:

1. **OEM Market Positioning:** Through robust analysis of OEM market share data by product type and end-market customer interviews, Gotham determined that the target's 2 key OEMs maintain the #1 or #2 position in each of the target's 8 T&M equipment categories and together face limited threat of market erosion from competitor penetration.
2. **OEMs' Commitment To The Indirect Channel:** Through a rigorous economic impact analysis, Gotham concluded that the shift to the indirect channel does not affect OEMs' profitability as the decreased SG&A costs offset revenue loss from lower distributor pricing while allowing OEMs to lower their fixed cost structure. Furthermore, our extensive customer interviews indicated that a majority of customers prefer distributors due to quick turnaround time and price advantage.
3. **Competition In The Indirect Channel:** Competitive analysis of the indirect channel indicated that the target was well-positioned over catalogs as its knowledgeable, "value-added" sales force provided an advantage in distributing higher-end, technical equipment. Furthermore, the target was mentioned as the preferred distributor by 70% of customers interviewed.
4. **Growth Outlook For The Target's Base Business:** Gotham built a growth model by end-market and established that market growth, along with indirect channel shift, would support target's base case growth projections. Furthermore, a state-by-state analysis of the target's market share and of its sales force presence indicated a 30+% market share gain opportunity.



Rentals Do Not Threaten Target's Primary Business Of Equipment Sales And Creates A Cross-Selling Opportunity

Gotham assessed the strategic fit of the target's rental business, which accounted for ~20% of annual revenue, through rigorous financial analysis and customer interviews. While the rental business requires high upfront CAPEX, Gotham's analysis confirmed the financial attractiveness of the rental business due to its high EBITDA contribution, its dampening effect on cyclicalities, and increased potential customer base. We determined that most companies both rent and buy their equipment, with the rentals primarily driven by short-term needs, as indicated by 83% of customers, presenting an attractive opportunity for the target to cross-sell products as a convenient one-stop shop for its customers.

Adjacent Markets Present Attractive Expansion Opportunity Through Acquisition

Gotham examined the possibility of expanding into 4 adjacent markets by modeling market size growth, identifying the synergies with the existing business, establishing economic attractiveness, and profiling potential acquisition candidates. Our analysis indicated that 2 of the adjacent markets presented an opportunity for the target due to: strong growth outlooks; large indirect channels with high distributor margins; and overlapping OEMs with which the target already maintains strong relationships.

The Outcome: Armed with Gotham's rigorous OEM, customer, and market due diligence findings, our PE client felt comfortable about the target's outlook and successfully completed the acquisition.