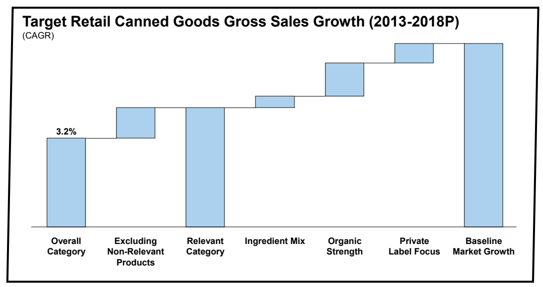
Customer & Market And Operational Due Diligence Of Private Label Canned Food Manufacturer: Establishing Growth Prospects, Margin Risk, CapEx Risk, And Operations Improvement Opportunities

The Challenge: Gotham's client, a middle-market PE firm, was engaged in a competitive auction to acquire a leading private label canned food supplier with a strong Hispanic-focused brand and a growing presence in foodservice. The target was growing faster than the category and was well-positioned to benefit from continued expansion in Hispanic foods and in organics, and from ongoing healthy eating trends. While excited about the target's leading position and growth prospects, our client had concerns about the company's ability to reach management's aggressive revenue targets, as well as margin and operational risks. Gotham's challenge was to: 1) establish the target's market position and growth outlook; 2) assess the risk of customer loss and of margin compression; 3) identify CapEx risk; and 4) validate management's operational savings plan and identify further opportunities.

Phased Growth Outlook, Competitive Positioning, And Operations Assessment: With only 2 weeks remaining before the bid due date, Gotham phased our due diligence approach to ensure the initial 2 weeks (Phase I) would address key components:

- **Growth Outlook:** Established target's category presence by analyzing IRI retail data by product type (ingredient, PL vs. brand, organic vs. conventional); identified key market trends through targeted market research; and built a model to project category growth rates by channel and product type.
- **Competitive Positioning:** Interviewed 27 PL and category buyers from supermarkets, wholesalers, foodservice companies, and brokers; assessed pricing/margin outlook; and profiled competitive landscape.
- **CapEx And Operational Risk:** Visited all 3 of the target's plants; assessed capacity situation; and reviewed operations improvement plans.

After our client won the bid and management offered greater data access (Phase II), Gotham conducted a deep-dive assessment of margin risk by analyzing historical pricing/margin trends (by SKU, product type, channel, plant, and customer), as well as the pricing outlook for key cost inputs (steel cans and agricultural commodities). Finally, following the purchase agreement (Phase III), Gotham performed an operations diagnostic of material yield, direct labor, and inventory to quantify cost savings opportunities in order to craft a post-acquisition value creation plan.



Well-Positioned For Growth With Favorable Product Mix And Strong Customer Positioning

Gotham projected the target's sales to grow at more than double the overall category CAGR of 3.2% as the target is overweight in fast-growing niches, including organics, PL, and 4 of the fastest growing ingredient types. The target can fully leverage its favorable product mix due to its strong positioning with customers, who value the target's organic product breadth, product innovation, and strong service for small and mid-sized retailers.

Manageable Margin Risk Due To Product Mix, Innovation, And Stable Outlook For Input Prices

Customer interviews confirmed Gotham's ingoing hypothesis that price was a primary driver of vendor selection and contracts were frequently rebid. Our analysis of 7 years of SKU-level company sales data found that growing sales of organics (significantly higher margins than conventional products) had offset margin declines in conventional products. Gotham concluded that overall margins should remain stable due to continued growth of higher margin products and price stability of the target's major inputs – steel can prices should hold given stable hot-rolled coil steel prices and tinplate production capacity that will exceed can demand. Further, the target's agricultural commodity price should stay stable as it is driven by corn prices (target's ingredients compete with corn for acrage), which are expected to remain relatively constant in the near future.

Sufficient Capacity For Planned Growth

Gotham's analysis of current utilization by can size demonstrated the target had sufficient capacity to meet projected growth, with a potential need for a second full-time shift in 2 years at one plant. Gotham also identified several potential practical options to expand capacity without major additional CapEx.

10% EBITDA Improvement And 30-40% Inventory Reduction Opportunity Beyond Management's Plan

Gotham's operational diagnostic revealed significant cost and inventory reduction opportunities, including:

- **Material Yield:** Our analysis of hydration targets and batch-level material yield indicated wide variability of food content in cans and opportunities to improve material yield by aligning standards and achieving best demonstrated performance across product lines.
- **Direct Labor:** The target's direct labor canning/production efficiencies were below both company standards and industry benchmarks, indicating a 12% direct labor cost reduction opportunity.
- **Inventory:** Using our SKU-level inventory model to statistically calculate target inventory level based on demand patterns, Gotham established opportunities to reduce inventories by 1-2 weeks overall (leveraging the demand stability of A SKUs) and by 3-4 weeks at a plant with systemically high inventories (setting more aggressive targets).

The Outcome: Gotham's phased approach provided the client the right information at the required level of detail at each stage of the deal process. Our pre-LOI findings gave the client the confidence to submit the winning bid based on a solid understanding of growth prospects and CapEx requirements. Post-win, Gotham's margin risk and operations opportunity assessment allowed the client to close the deal with confidence and to set the stage for post-acquistion value creation.

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