

Customer & Market And Operational Due Diligence Of Leading Processor Of Freeze-Dried Fruits And Vegetables: Rapid Assessment Of Technology, Competitive, Customer Concentration, And Operational Risks

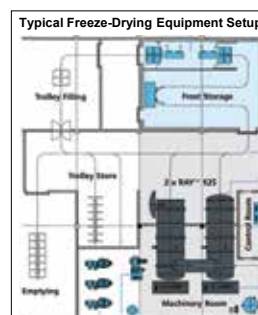
The Challenge: One of Gotham's long time PE clients was looking to invest in a leading processor of freeze-dried fruits and vegetables. The target claimed that it had the most efficient freeze-drying facilities that yielded superior products. However, our client was concerned about the target's competitive positioning: both its freeze-drying technology vs. other drying technologies; and its positioning vs. domestic and international freeze-drying processors. Furthermore, our client was concerned about the stability and growth outlook of the target's largest customers. Our client asked us to conduct a 2-week customer & market and operational due diligence to (1) assess technology risks; (2) assess competitive risks; (3) assess the stability of the target's largest customers; (4) conduct a top-level operations assessment; and (5) validate the sell-side growth opportunity assessment.

2-Week Rapid Risk Assessment: Gotham conducted extensive primary and secondary research to assess 5 due diligence areas:

- **Technology Risks:** Interviewed 20+ academic experts, equipment suppliers, competitors, and customers to understand the process, applications, cost, quality, and adoption of key drying technologies. Gotham established advantages/disadvantages of freeze-drying technology, leveraging a robust technology evaluation framework incorporating food quality (e.g., color, appearance, nutrients), operational attributes (e.g., processing speed, batch size), and cost (e.g., CapEx, operating costs).
- **Competitive Risks:** To assess the target's positioning against domestic players, Gotham interviewed 12 players and leveraged industry data to establish competitive landscape and profiles of key domestic players, including positioning, expansion plans, and end-market focus. To assess the import threat, Gotham conducted interviews with key manufacturers, importers, and customers to understand capacity, variety, and volume of exports and profiled key players in South America, China, and Europe.
- **Customer Concentration Risks:** Gotham focused on the top customer in each of the target's 2 largest end-markets – cereal and foodservice beverage – and interviewed key executives to understand supplier dynamics and the target's positioning vs. other suppliers, analyzed menu/offerings, and conducted extensive research to establish growth outlook of end-products.
- **Top-Level Operations Assessment:** Established that the target's operations posed no significant risks based on a plant walk-through and information available in the data room.
- **Sell-Side Growth Opportunity Validation:** Leveraged data available for 6 end-markets (cereal, beverages with fruit, snack bars, packaged snacks, confectionary, and pet foods) from news releases, investor presentations, commercial and government databases, and other sources to validate outlook for underlying end-markets and demand for freeze-dried fruits and vegetables.

Freeze-Drying Technology Offers Superior Characteristics That Align With Healthy Eating Trends

Gotham established that although the cost of freeze-drying technology is higher than other drying technologies, freeze-drying offers a superior quality product (better nutrients, shape, color, and flavor) that is more in sync with healthy eating trends. While air/sun drying is the lowest cost process, it is a slow and seasonal process and poses a risk of food spoilage; infuse drying replaces water in fruit with sugar syrup/glycerin making it unhealthier; and microwave drying results in a slight loss in nutrients and product quality is lower compared to freeze-drying. While emerging radiant energy vacuum (REV) technology offers a slight cost advantage and the structure and appearance of the fruits is similar to freeze-dried products, the REV process does not retain same level of nutrition and flavor and has inferior rehydration capacity. Many of the claims around the success of REV technology were exaggerated and widespread adoption would be constrained by exclusivity agreements and extensive R&D requirements.



Manageable Competitive Risk With Limited Import Threat

Gotham's detailed cost analysis established that domestically, most large players custom build their equipment ~20-30% cheaper than purchased turnkey solutions. While the target was well positioned among its customers, large players had fairly similar capabilities. Target had been benefitting from a shortage of U.S. capacity relative to demand. However, all major domestic players were in the midst of capacity expansion, potentially creating a risk of overcapacity. Internationally, Gotham established low import risks from South America and Europe since players had insufficient capacity to meet U.S. demand. Although, China had significant spare capacity and a cost advantage, unreliable product quality made the import threat from China limited in the near to medium term.

Stable Growth, However Potentially Increased Margin Pressure From Top Customers

While the sell-side assessment indicated that sales of cereal with fruits is expected to grow, our analysis indicated that sales of cereal with fruits have declined in line with overall cereal sales. However, the target's sales to its largest customer were growing, as the customer was increasing fruit content in its cereals and the target was gaining wallet share at the customer. Our interviews established that this customer worked with all major processors and price played an important role in their supplier selection criteria.

The target's sales at its largest foodservice beverage customer had grown and Gotham's research/analysis indicated that the customer intended to grow the beverage with fruits category as part of its strategy. However, Gotham's past experience with this customer suggested that the target's high margins were driven by the emerging nature of this category. We felt should the category continue to grow, it would come under the radar of sourcing at some point creating competitive pricing pressure.

The Outcome: Gotham provided the client with clarity on technology, competitive, customer concentration, and operational risks ahead of the bid date. Gotham's assessment established while the market was growing and the target was well-positioned and poised for growth, it could potentially face increased competitive intensity and margin pressure. Our client accounted for all these risks and tempered growth projections in its model.