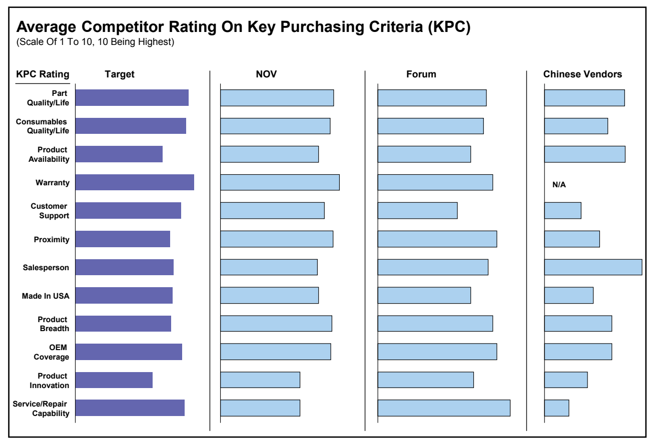
Customer Due Diligence Of An Oil & Gas Aftermarket Parts Supplier: Determining Purchasing Processes, Competitive Positioning, And Market Trends

The Challenge: Our client, a mega buyout firm, was pursuing an add-on acquisition for one of its portfolio companies, a multi-billion dollar oil & gas drilling equipment supplier, to enter the aftermarket replacement parts and consumables market. While this PE firm typically prefers to do customer interviews themselves, they ran into challenges reaching key decision makers at major drilling companies despite contacts from existing equipment sales relationships. To gain critical customer insights from the target number of major drillers within the due diligence timeframe, Gotham was brought in to interview a targeted 12-15 key stakeholders to: 1) determine whether purchasing decisions are made at the drill site or at corporate; 2) establish the target's positioning vis-à-vis key competitors; and 3) understand market risks and opportunities in light of low oil prices and technological changes.

Customer Interviews With Major Drilling Companies: Gotham refined the client-developed questionnaire to leverage our experience interviewing oil & gas customers and conducting unsolicited interviews. Using our professional network and proprietary database of oil & gas contacts, Gotham identified decision makers who then accounted for ~80% of interviews. To ensure the robustness of customer interview results, Gotham ultimately conducted 31 anonymous interviews with personnel at rig sites, maintenance yards, and corporate headquarters of on-shore and off-shore drilling companies, including Helmerich & Payne, Nabors, Ensign, Patterson-UTI, Schlumberger, and TransOcean.

High Cost Of Rig Downtime Drives Purchasing Preferences

Gotham performed a conjoint analysis to establish the target's positioning vis-à-vis key competitors by asking customers to identify key vendor selection criteria, rate each criterion on a 1-10 scale, and then rate key competitors on those criteria. Given the high cost of downtime, quality and product availability were significantly more important than any other criteria. The high downtime cost also made customers value customer support and quality salespeople because responsive vendors can prevent or minimize rig downtime during a crisis. However, drillers value OEM coverage much less and typically buy from multiple vendors, prefering 3rd party vendors over OEMs. The target's price point was ~15% lower than market leader NOV's, but in line with that of the remaining domestic producers. Cheaper Chinese manufacturers have made some inroads in drilling equipment, but customers overwhelmingly preferred domestic consumables due to downtime-driven concerns about quality/product lifetime.



Complex And Changing Purchasing Dynamics Involving Both Rig Site And Central Purchasing

Although the target's sales efforts focused on drill sites (where physical presence in multiple drilling areas is important and local trucks manage sales relationships), our client's small sample of interviews had indicated that most purchasing was centralized. Subsequent Gotham-conducted interviews covered a range of functions (purchasing, maintenance, central purchasing) and companies (large, small; onshore, offshore) and found that purchasing responsibility varies by product type and company size. Replacement part purchasing dynamics are complex because of infrequent need as replacement parts are only purchased when there is a problem that cannot be cost-effectively repaired. Since replacement parts are expensive ($25,000-35,000), they are usually purchased centrally and sometimes sole-sourced. Consumables, on the other hand, are relatively cheap ($100-300) and replaced frequently, so purchases are usually made by the drill site at local supply stores to minimize disruption to drilling operations. Company size also influences purchasing as larger companies are shifting decision-making authority from rigs to yards and centralized purchasing, despite some resistance from rig managers/superintendents.

While Oil Price Decline Will Impact Near Term Demand, Some Market Trends Are Favorable

Our client was concerned that reduced driiling activity caused by low oil prices might drive drillers to change their maintenance schedules to reduce cost. However, our interviews revealed that while the decline in drilling activity will reduce the need for replacement parts, drillers will not change maintenance spending on a per-rig basis due to the disproportionate cost of rig downtime vs. proper maintenance. Additionally, we established that the industry was going through an upgrade cycle to support horizontal drilling requirements. Domestic producers with a reputation for quality, such as the target, will benefit from these upgrades because part wear-out on the high-pressure equipment used in horizontal drilling is relatively quick, increasing both overall demand along with the importance of product lifetime as a purchasing criteria.

The Outcome: Gotham's deep customer insights provided a detailed understanding of purchasing, quantitative data regarding selection criteria and vendor performance, and a first-hand customer account of market trends, allowing our PE client to submit a well-informed bid.

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