

Customer & Market Due Diligence Of Leading Road Maintenance Equipment Supplier: Assessing Revenue/Growth Risk Pre-LOI

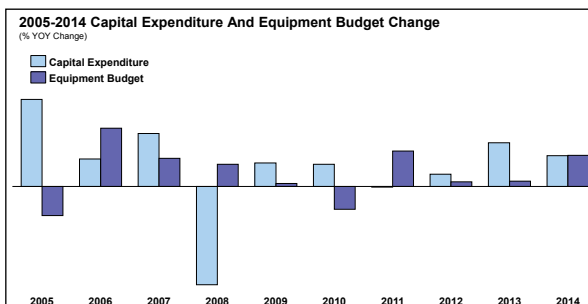
The Challenge: Our client, a mid-market PE fund, was preparing a bid to acquire a leading road maintenance equipment supplier to state transportation departments (DOTs) and municipalities. Our client was attracted by the target's steady 10% CAGR growth over the past 10 years even through recession-driven government spending cuts, as well as by its market-leading product innovation capabilities and strategically located installation/customization (upfitting) facilities. To validate the sustainability of the target's growth and market leadership position, our client asked Gotham to: (1) establish state DOT/municipal budget dynamics; (2) understand target's competitive positioning; and (3) pin down growth trends of the target's road maintenance equipment market.

Pre-LOI Road Maintenance Equipment Market Risk Assessment: To accommodate our client's desire to minimize expenses prior to exclusivity, Gotham structured a phased approach focusing the 2-week pre-LOI assessment primarily on the state DOT market (the target depended heavily on large state DOT contracts), with only a top-level assessment of the municipal market. To pin down the target's revenue/growth risks, Gotham:

- Compiled 10 years of state DOT budget details for 30 key states from government data sources, including federal transportation statistics and state budget documents
- Conducted ~50 interviews with state DOTs (and some local municipalities) to pin down their purchasing criteria and processes, the target's competitive positioning, and transportation equipment budget dynamics
- Built a profile of state DOT equipment fleets (including number, age, and manufacturer by type of equipment) by leveraging equipment information available on state DOT website and mining equipment RFPs/IFBs, and filling information gaps via our primary research
- Established the competitive landscape in the road maintenance equipment market and profiled the target's key competitors.

Road Maintenance Equipment Replacement Cycles Lengthening Due To Budget Cuts And Improved Durability

The target's management believed that recessionary budget cuts restrained market growth over the past few years and the road maintenance equipment market would bounce back post-recession, accelerating the target's already impressive revenue growth. To assess management's viewpoint, Gotham conducted a line-by-line analysis of state DOT budgets over the past 10 years and established that because of the critical nature of road maintenance equipment the purchases are less impacted by recessionary budget cuts than other categories. However, while customer interviews indicated state DOTs are maintaining fleet size, DOTs have pushed back equipment purchases by 1-2 years due to both recessionary budget constraints and improved equipment durability driven by the growing use of stainless steel and new technologies. Gotham estimated that the longer replacement cycle would dampen growth and possibly shrink market size as equipment pricing growth may be unable to keep up with potential unit declines.



Target Is 1 Of 4 Well-Positioned Players In The Market, With Little Differentiation Among The 4

Based on insights from customer interviews, state DOT fleet profiles, and our competitive capabilities analysis, Gotham established that the target is 1 of 4 equally positioned players that can meet state DOT equipment specifications and quality standards. While its product innovation capabilities did provide the target some access to state DOTs, this did not translate into significant competitive advantage as long purchasing cycles and DOTs' reluctance to specify technologies that may limit the number of bidders enable competitors to introduce similar technologies. We also established that the target's network of upfitting facilities, while larger than its competitors, did not provide significant competitive advantage as state DOTs did not highly value these capabilities due to wide availability of installation options, including in-house facilities. The target's industry-leading network of dealers did, however, provide it with a slight advantage in securing high-margin state DOT turnkey contracts, which are primarily bid through these truck chassis dealers.

Target's Concentration In State DOT Contracts Creates Risk

Given that the target's revenue sustainability and growth depend heavily on state DOT contracts, Gotham assessed the potential risks of contract losses and pricing pressures. Our customer interviews and 5-year historical RFP/IFB analysis showed that state DOTs primarily choose vendors based on price and rebid contracts every 3-5 years. As the target is 1 of 4 equally-positioned players in the market, Gotham concluded that the target has a high risk of DOT contract loss or margin compression in this highly competitive, price-sensitive market, potentially threatening the management's 5-year revenue and EBITDA plan given that many municipalities also buy equipment off the state DOT contract to take advantage of contract pricing.

The Outcome: Gotham's due diligence findings provided our client with a solid understanding of the customers' budget dynamics, the market outlook, the target's competitive positioning, and the risks involved with dependency on regularly rebid price-sensitive state DOT contracts. Given that Gotham's fact-based assessment painted a less optimistic picture than management's projections, our client decided not to pursue the acquisition.