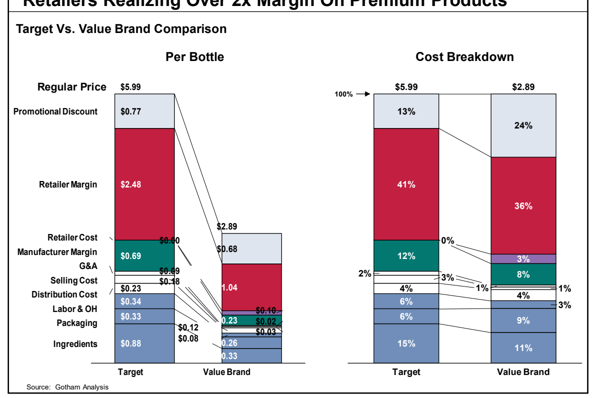
Customer & Market Due Diligence Of Family-Owned Specialty Foods Manufacturer: Validating Growth Potential And National Expansion Feasibility

The Challenge: A mid-market PE firm was in exclusive negotiations with a family-owned premium specialty foods manufacturer. The target, a strong regional brand servicing supermarkets in Northeast through in-house DSD network, had begun expanding beyond the Northeast through specialty foods distributors. In addition to branded products, the company also manufactured private label products for leading supermarkets and warehouse clubs, and co-packed products for several leading premium brands. A key element of the PE firm's investment thesis was to expand the brand nationally. To help validate it's thesis, the PE firm asked Gotham to conduct a Customer & Market Due Diligence to establish/validate: (1) positioning and outlook of premium product companies in the marketplace; (2) the target's positioning in the premium product space; and (3) feasibility and requirements of expanding the brand nationally.

The Partnership:
<u>Analysis</u>: To build a solid fact base, we leveraged a multitude of information sources, including: IRI/Nielsen data; secondary research; modeling; field research; and interviews with supermarket buyers, food distributors, and other industry experts. Our analytical and research effort focused on 3 critical issues relevant to the investment thesis:

- To establish **positioning and outlook of premium product companies in the marketplace**, Gotham pinned down a discernible shift from mid-value to the premium segment in the market as a result of increased focus on healthier products, supermarkets launching their own premium private label brands, consumer using premium products at home as a cheaper alternative to eating out, and high number of premium product introductions in this category. Next, Gotham conducted a "farm-to-fork" value chain analysis of premium vs. value products to understand risks posed by large, national players entering the premium product segment. Leveraging the parallel Operational Due Diligence effort conducted by another Gotham team, the Customer and Market Due Diligence team built a cost and margin profile of the target's value chain, including ingredient and packaging costs, labor and overhead costs, logistics and promotional costs, manufacturer margins, and retailer margins. Gotham team then established the cost and margin picture for the value brand leveraging Gotham's expertise and knowledge base. Our analysis confirmed that value brands use cheaper ingredients and a high-volume manufacturing process that is detrimental to the product taste. Further, retailers support premium products as they realize more than double the margin than on value products.
- **Target's positioning in the premium product segment** was found to be strong in Northeast region based on a detailed analysis of IRI/Nielsen data and field visits to Supermarkets in Northeast region. To understand the national picture, Gotham conducted an extensive search of brands present in this category and identified close to 500 brands. However, most were small, primarily regional players, with only 1 premium brand with national presence.
- **Feasibility and requirements of expanding the brand nationally** was established through "voice of customer" interviews, modeling various expansion scenarios, and Gotham's expertise in this space. We established that the target's success in penetrating Northeast markets through its DSD model was due to long history of brand in this region; national expansion, however, would require use of specialty distributors. We modeled the economics of using specialty distributors and found that the lower distributor pricing vis-à-vis direct to supermarket was mostly offset by lower distribution costs. In short, the benefits of using distributors far outweighed the small loss of margins.

Value Brands Cost Lower Due To Low Quality Products And Retailers Realizing Over 2x Margin On Premium Products



<u>Strategy</u>: Gotham recommended 4 growth levers for the target: (1) expand geographically by leveraging specialty distributors; (2) develop a fuller product presence at existing direct supermarket accounts that utilizes its full product line capabilities; (3) leverage its strong reputation as a private label/co-packer/warehouse club supplier and grow its business via a focused sales approach to increase its large accounts volume; and (4) possibly acquire regional players to gain access to local markets in other regions.

The Outcome: The PE firm gained confidence in the growth potential of the target and decided to move forward, subsequently closing the deal to buy the target.