

Customer & Market Due Diligence Of Electrical Connector Supplier: Establishing Utility Market Dynamics And Target's Growth Outlook

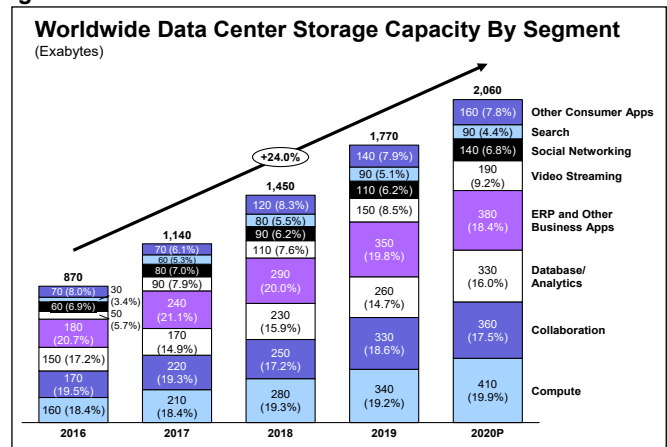
The Challenge: One of our PE client's portfolio companies, a diversified manufacturer of electrical components serving the commercial & industrial (C&I) end-market, was looking to acquire a specialized manufacturer of electrical connectors serving the utilities and OEM end-markets. Our client was attracted by the target's growth, its exposure to the growing data center market, and the opportunity to expand into the utilities end-market. However, our client wanted to better understand the target's growth outlook and potential low-cost sourcing risk and asked Gotham to conduct a 2-week customer & market due diligence to establish: (1) utility end-market dynamics/trends; (2) purchasing behavior in the utility end-market; (3) data center growth outlook; and (4) competitive dynamics in the electrical connector market.

Utilities And Data Center Market Analysis: To establish the market and competitive dynamics in the electrical connector market, Gotham undertook a multi-pronged approach:

- Conducted 23 anonymous interviews and surveyed 179 distributors, manufacturers' reps, OEMs, contractors, and utilities to gain insights into: the target's reputation and competitive positioning; electrical connector demand in the utility end-market; and utilities' key purchasing criteria, buying behavior, and distributor dynamics
- Built a utility electric connector product map identifying all applications (e.g., underground distribution, overhead transmission), types (e.g., switchgear lugs, neutral bars), and technical specifications; established competitive segmentation and positioning, end-market focus, and reputation for each key player; and assessed the target's utility product offering vs. those of competitors to identify product portfolio growth opportunities
- Identified demand drivers for data centers and established growth outlook based on investment and new construction forecasts
- Determined the utility connector demand outlook based on utility CapEx trends, OpEx, and connector use by upgrades, maintenance, and new/growth.

Utility Infrastructure Undergoing Significant Upgrade, Leading To Positive Growth Outlook For Electrical Connectors

Utilities are nearing the end of their 20- to 25-year transmission asset renewal program to improve reliability and incorporate new generation sources and are now shifting to upgrading aging distribution assets (45% of assets near end of useful life). Coupled with storm hardening projects, these upgrades will drive distribution CapEx moving forward. Because utilities generate profit by earning capped returns on CapEx, they have incentive to file rate cases with their public utility commissions to fund these upgrade projects. As upgrades make up ~60% of the electrical connector demand, the target has an opportunity to benefit from distribution demand growth by leveraging its brand reputation, deepening and broadening its utility product line, and increasing price competitiveness. In addition to upgrades, electrical connectors are MRO items stocked in local storerooms for use by linemen and engineers, driving a steady maintenance demand (~30% of distribution electrical connector demand). To participate in the utility market, suppliers typically work with manufacturers' reps and have to gain product approval by standards engineers (specs, quality, brand, and product features play a role) to participate in a bid. Once approved, price and availability are the most important criteria for winning the order – Made in USA is desirable but products manufactured overseas are slowly becoming acceptable if they have good quality.



Data Center Growth Expected To Continue, Driving Demand For Electrical Connectors

Over the past decade, the number of data centers has been growing rapidly driven by the increasing number of mobile devices, the advent of "Internet of Things", and advancing computing technology requiring larger bandwidth and more data, with no signs of this growth slowing. The majority of this growth was in hyperscale data centers – large facilities run by companies like Google and AWS. A large data center can consume as much power as a town of 60-75K people and require utility-scale substations and other electric equipment. The segment is a strong driver of electrical connector growth with the majority of electrical connectors in a data center found in switchgears, panelboards, transformers, and other OEM products.

OEM Connector Purchases Shifting To Low-cost Countries

Lugs and neutral bars are required by OEMs of switchgear, transformers, panelboards, meter sockets, and other electrical equipment, making OEMs a significant segment of the electrical connector market. Recently, OEMs have qualified Indian and some Chinese suppliers to overcome supply disruptions in 2018/2019. The major domestic suppliers to the OEM end-market did not invest sufficiently in capacity to keep up with demand growth (driven by economy growth, infrastructure upgrades, and data center growth), and operational issues at a major supplier in 2018 tipped the OEM market into a shortage situation with long lead times. However, the target is only competitive in low-volume, larger electrical connectors and is, thus, less exposed to low-cost competition.

The Outcome: Gotham established that the data center and utility markets will continue to drive growth in demand for electrical connectors and low-cost sourcing is not affecting the target because of its low-volume products. With a clear, fact-based understanding of the utility market dynamics and the target's growth outlook, our client was able to successfully close the deal.