

## Customer & Market Due Diligence Of Electric And Gas Utility Contractor: Establishing Market Size, Competitive Positioning, And Margin Sustainability

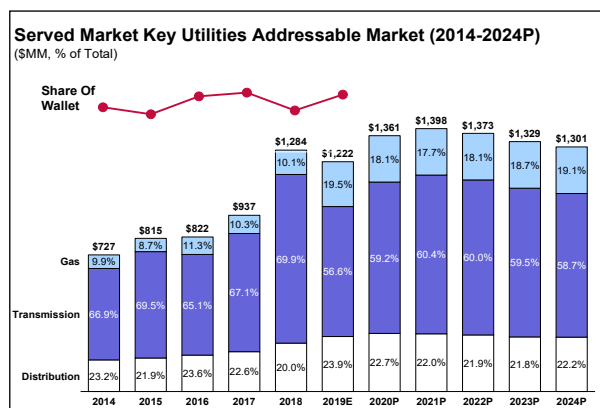
**The Challenge:** One of our longtime PE clients was looking to invest in a family-owned utility infrastructure service provider with a leading position on electric line, substation, and natural gas construction projects across several Midwestern states. The target was benefitting from utility investment in upgrading aging infrastructure and building new infrastructure required to support renewable wind and solar power generation capacity. Our client was excited by the target's local market leadership position, the planned CapEx by utilities in the target's served markets, and the target's planned expansion to 5 adjacent states. To pin down local market and competitive dynamics, our client asked Gotham to conduct a 3-week customers & market due diligence with the following objectives: (1) establish the target's margin sustainability; (2) establish the target's reputation and competitive positioning; and (3) establish and size the growth opportunities both in the current and expansion markets.

**Utility-specific Spend And Competitive Dynamics Assessment:** For each of the key electric and gas utilities in the target's current and expansion states, Gotham:

- Analyzed utility spend data to build a transmission and distribution CapEx and maintenance spend profile of 30 utilities, estimated the target's wallet share trend at top customers, and established planned utility construction projects in all relevant states
- Conducted interviews with key transmission and distribution executives at top utility customers to gain further insights into the CapEx outlook, spend drivers, vendor selection criteria, the target's reputation/competitive positioning, and outsourcing trends
- Carried out a state-by-state deep dive to develop a competitive landscape of the profile of key competitors
- Analyzed the target's financial data to establish a margin profile by division, state, and project size to determine the profitability of the target's various operations and variations from contract margins.

### **\$1.3B Served Market Expected To Grow At 1.3% CAGR**

Gotham's utility-by-utility spend analysis determined that the target is currently participating in a \$1.3B market, 95% of which is CapEx-driven by: asset renewal/reliability upgrades (e.g., reconductoring, repair, substation upgrades, voltage upgrades, storm hardening, undergrounding, pole replacements) on 50-100 year old electrical infrastructure; construction of new transmission lines and substations to support regulation-driven renewable energy projects and load growth/system capacity increases; investment in distribution infrastructure to support local power generation sources (e.g., rooftop solar, microgrids); and replacement of older cast iron/steel gas pipes due to corrosion issues, as well as plastic Aldyl-A pipes manufactured before 1973 due to brittleness. Our interviews with utility executives and analysis of their project pipeline indicated that this CapEx trend would continue for at least another 10-15 years. Risk of project cancellation is low – projects are planned years in advance and funding is secured before a project starts. Recessionary risk is also low as most CapEx projects are tied to reliability; only growth projects (e.g., new service for housing development) get impacted by recession. Outsourcing is driven by utilities not having capacity to support growing CapEx and they do not want to add staff, suggesting a growth in outsourcing levels. Beyond the currently served market, the target's growth strategy would expand the target's addressable market by an additional \$3.5+B: \$2B of spend with growth utilities (not served by the target currently) in the target's currently served states; and another \$1.5B+ spend by utilities in 5 expansion states.



### **Target One Of The Preferred Contractors, With A Wallet Share Of ~10%**

Gotham's state-by-state competitive landscape assessment identified ~75 competitors, categorized by geographic presence (national, regional, or local) and capabilities (electric T&D-focused, broad electrical contractors, underground gas pipe installers, and contractors providing both gas and electric construction and maintenance services). As for purchasing dynamics, safety is a prerequisite for a contractor to even be considered due to utility liability. After safety, credibility/reliability, quality, and expertise are the top criteria for contractor selection and pricing is a low consideration. We established that the target is one of the preferred contractors in its served market with a good track record on safety, quality, and delivery and holds a ~10% share of its customers' wallets. In fact, smaller projects do not even require public biddings, making the target a top-of-mind alternative as selection is dependent on contractor's reputation and relationship with the project manager. Lastly, barriers to entry for an electric and gas utility contractor are high as utilities like to primarily work with contractors with a solid track record of success.

### **Margins Vary By State, Infrastructure Type, And Project Size**

Gotham's analysis of the target's project data revealed that the target's margins vary significantly from project to project. The target's highest margins are obtained in electric substation projects, followed by electric lines and gas projects. The level of subcontracting on a project also has a significant impact on margin performance, as do local competitive dynamics — in fact, the target's lowest margin state had a very competitive contractor services market. Regarding project size, ~65% of the target's dollar margins came from projects over \$1MM, even though smaller projects have higher margins. The target's actual margins are also impacted by WIP project accounting procedures, making them different from contractual margins until the project completion.

**The Outcome:** Gotham's utility-by-utility assessment of the target's current and expansion states provided our client with clarity on the target's margin sustainability, competitive positioning, and growth opportunities. Armed with this robust, fact-based understanding of the target's local markets, our client pursued the target aggressively.