

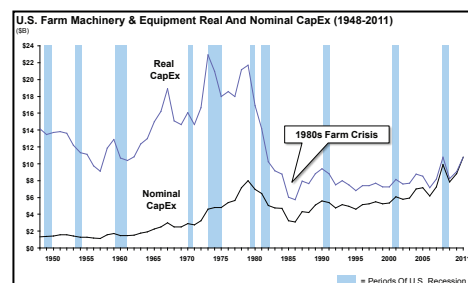
Customer & Market Due Diligence Of Fluid Power Equipment Company: Establishing Demand Cycle Phase For Key Markets And Competitive Positioning

The Challenge: Our client, a large PE firm, was considering an add-on acquisition to an existing portfolio company in the fluid power component space in order to diversify end-market exposure and broaden the scope of capabilities to include smaller components for OEM customers. The PE firm wanted a deeper understanding of the target's market and competitive dynamics, especially given its exposure from its highly cyclical agriculture and construction equipment end-markets. Having previously worked on the PE client's platform investment, Gotham was brought in ahead of the final bid round to quickly validate the target's growth outlook, including current demand cycle phase for these two key end-markets, and to pin down competitive risks.

Robust End-Market Assessment: Gotham took a multi-pronged approach to analyze each end-market: (1) secondary research to develop a robust fact base across each end-market, including target's component requirements in key equipment categories, competitive assessment of component suppliers, and outlook for top OEMs; (2) macro-economic research on the demand cycle and drivers; (3) 75 customer calls to establish component demand and sourcing trends (e.g., shift to overseas suppliers), understand equipment demand drivers, and pin down target's competitive positioning; and (4) market sizing and growth modeling for target's product across key equipment categories in each end-market by first establishing key pieces of equipment for these fluid power components and then estimating size/cost of each component.

Agriculture Equipment Market Near Demand Cycle Peak, Driven By Farm CapEx And Income Growth

In assessing the U.S. agriculture equipment market, Gotham investigated key market drivers including: U.S. farm CapEx and income growth, in turn driven by government policies/incentives and commodity price performance of key crops (corn, soybean, and wheat). We sized the market for target's components in relevant agriculture equipment segments at \$130MM and projected it to grow 5.2% annually led by demand for harvesting equipment and OEM exports (\$11.9B in 2012) to developing nations looking to modernize farming capabilities. However, with domestic farm CapEx on non-tractor equipment reaching a record \$10.8B in 2011, coupled with a projected decline in corn futures and uncertainty around planned expiration of accelerated depreciation tax incentives, demand was estimated to be near or at the peak of the cycle.



Demand For Components In Target's Construction Equipment Focus Segments Projected To Grow 9%

Gotham sized the market for outsourced components in the target's relevant construction equipment segments (access/lift, compact earthmoving, and truck-mounted cranes) at \$125MM and projected growth at 9%, with most small to mid-sized OEMs preferring to outsource components. Our assessment, which included a detailed analysis of U.S. construction activity and demand outlook, showed construction equipment was somewhere between the beginning and middle of a growth cycle following 2009's low-point, primarily driven by the rebound in residential construction activity (19% CAGR), healthcare renovations on the non-residential side, and demand for power infrastructure (especially for production and use of shale oil & gas). Our team also evaluated the equipment rental fleet segment, which represents a high portion of construction equipment market in target's key categories (as high as 50%); we found that although many rental companies had increased CapEx post-recession to replenish aging fleets, higher utilization rates will continue to drive equipment demand.

Outlook For Trucks And Compaction Equipment End-Markets Signals Moderate Growth Prospects

In addition to our in-depth investigation of the target's primary end-markets, Gotham performed a top-level assessment of the target's smaller trucks and compaction equipment end-markets (accounting for nearly a quarter of sales). Our assessment showed a 6-7% growth in equipment for these end-markets, with each representing ~\$55M in total opportunity for target's components. Truck equipment (e.g., dump truck hoists, snowplows, liftgates) will benefit slightly in the near term from pent-up replacement demand from delayed CapEx, while compaction equipment growth will be driven primarily by recycling activity (vs. waste generation side), since major waste management companies already invested in equipment replacement over the previous 2 years.

Target Well-Positioned Vs. Key Competitors, With Minimal Threat From Large Players Or Low-Cost Chinese Suppliers

Gotham profiled competitors in terms of end-market presence, key manufacturing capabilities, level of customization, etc., and interviewed customers about top vendor selection criteria, including consideration of larger global players and low-cost overseas suppliers. We concluded that the target is well positioned against the ~60 small and mid-sized companies in its direct competitive set, with its design capabilities and collaborative design process highly valued by OEM customers. We also found that larger competitors pose little threat and are not competitive on key selection criteria (price, service, customization, turnaround time), and that most OEMs are were reluctant to source directly from China due to longer turnaround time and quality concerns – while imports from China are rising, they only account for 2% of the market and are primarily driven by U.S. players establishing Chinese operations (vs. Chinese companies penetrating U.S. market).

The Outcome: Based on Gotham's due diligence findings on the outlook for the target's key end-markets, including demand cycle status, our PE client was able to proceed to the final round bid with confidence.