

Customer & Market Due Diligence Of Testing Instrument Supplier To Govt. Agencies: Establishing Use Cases and International Expansion Opportunity

The Challenge: One of our long-term PE clients was in exclusive negotiations to acquire a leading supplier of niche testing instruments to government agencies in the United States. Our client was excited by the target's market-leading position in this highly regulated product space and the target's potential to expand to international markets, but wanted to pin down the size of this international expansion opportunity. Furthermore, our client was concerned about a potential threat to the target's market-leading position due to the emergence of a new technology from a recent entrant in the market. As such, Gotham was asked to conduct a 3-week customer & market due diligence with the following objectives: (1) assess the domestic and international market dynamics and growth opportunities; (2) determine the target's competitive positioning; and (3) identify any technological risks.

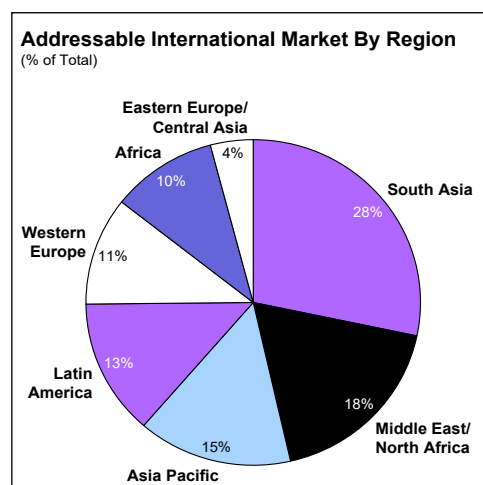
Niche Government Market Analysis: To address these due diligence objectives, Gotham undertook a comprehensive, data-driven due diligence effort, including:

- Conducting interviews with users, distributors, and industry participants to gain insights into: equipment usage and growth opportunity; purchasing decision criteria, frequency, and use cases; and the target's reputation/competitive positioning
- Building a country-level market sizing model to estimate the total addressable market for the equipment based on: size of countries' defense forces, intelligence agencies, police forces, and other product use segments; workforce attrition rates, testing, and utilization; various socioeconomic factors (e.g., freedom index, rule of law, criminal behavior, women's safety, drug use)
- Analyzing available government/market data and conducting secondary research to gain insights into overall market dynamics and trends, new technologies and innovations and associated risks, and the overall competitive landscape.

International Expansion Opportunity Significant, With Additional Opportunity To Shift To A SaaS Model

The target's flagship product is primarily used by federal, state, and local government agencies in the United States and some countries in Latin America that have a history of cooperation with the U.S. The international market for this product was still emerging due to export restrictions, limited familiarity and availability of skilled technicians to conduct tests, and limited international sales effort by the target. Gotham's market sizing model estimated a current international penetration rate of only 6%, highlighting the potential magnitude of international expansion. Our country-level addressable market and penetration rate analysis allowed us to pinpoint specific regions and countries where the target's product could experience significant user growth, and our interviews with international distributors allowed us to confirm the opportunity and develop an international expansion plan for the target.

Additionally, our interviews established that software/ease of use was the leading performance indicator for users of the testing equipment, contrary to what the target believed as it still held a "hardware first" mindset. The target also uses a legacy software model whereby many users still acquire their software through CDs and receive free annual upgrades. By upgrading to a cloud-based SaaS system, software updates could be implemented continuously, and users could more easily share results with each other, leading to increased product satisfaction. Furthermore, a subscription-based software model could also open additional revenue models (e.g., pricing based on per test) and add more steady revenue streams to lumpy hardware sales.



Use Cases Vary By Government Agency And Most Commercial Use Cases In The U.S. Prevented By Law

As the target's testing instrument is not permitted for most commercial use cases in the U.S., government agencies constitute the bulk of the target's customer base. The use of this testing instrument varies by federal agency (different regulations govern usage for different agencies) and by state/local government (depending upon the state law and budgetary picture). While some agencies use the instrument exclusively for screening, others use it for diagnostic purposes. By determining the use cases for each agency, we quantified each agency's total addressable market and penetration rates to decipher whether further domestic growth is possible. While defense, intelligence, and federal law enforcement agencies had penetration rates at or near 100%, there is room for expansion among state and local law enforcement markets where the penetration rate was only 43%.

New Technology Not A Threat To The Target And Can Be Leveraged To Expand Addressable Market

The target's best-in-class testing instrument has long been the preferred choice of government agencies and there has not been a significant competing technology. However, a new market entrant recently introduced a technology that was less expensive and easier to use, thus alleviating the need for skilled technicians. By analyzing key technical differences between the target's product and the new competitor's product, we determined that the target's instrument remains well-positioned due to its reputation, accuracy, and customer service – all important factors for government use. The competing technology had a limited traction with some local law enforcement and some international commercial use cases. We established that a few changes would allow the target to incorporate the emerging technology in its products and expand its customer base beyond governmental agencies. We also identified an opportunity for the target to expand the market for this instrument and access more price-sensitive customers by developing a less expensive version of its flagship product to target use cases that do not require high accuracy.

The Outcome: Gotham's robust, data-driven assessment provided our client clarity on the market dynamics and uses cases, the target's reputation/competitive positioning, as well the target's growth opportunities. Armed with a fact-based international expansion plan, our client moved forward with the confidence to successfully close the deal.