

Customer & Market And Operational Due Diligence Of Mexican Food Manufacturer: Validating National Expansion Opportunity For A Regional Brand

The Challenge: One of Gotham's PE clients was pursuing a hotly contested auction for a family-owned authentic refrigerated Mexican food manufacturer with a category-leading retail brand and a strong presence in foodservice channels. The target's product were at the intersection of multiple favorable market trends, including: growth in the Hispanic population/younger Hispanics looking for convenient but authentic food option; mainstream adoption of Mexican and other ethnic foods driven by Millennial consumers; and a shift in demand from frozen to refrigerated foods as consumers seek fresher, clean-label foods. Given the target's strong presence in California and the surrounding states, our client's investment thesis included future growth from national expansion potential. Accordingly, Gotham was asked to conduct a 2-phased due diligence to: (1) validate the national expansion opportunity in grocery, (2) validate the growth opportunity in foodservice, and (3) assess operations risks and opportunities.

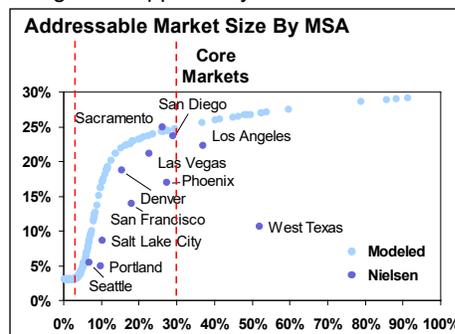
Fact-based National Expansion Opportunity Assessment: Gotham rapidly established a robust fact base through our multi-pronged, targeted research and analytical effort that included:

- Interviews with ~40 category buyers at leading grocery retailers, e.g., Albertsons/Safeway, Kroger, Publix, Wegman's, and Costco; and Hispanic grocery chains, e.g., Cardenas Markets, Fiesta Foods, to understand the brand's positioning in the current markets and the willingness of category buyers to carry authentic Mexican meats in expansion markets
- Consumer panel surveys of ~4,000 consumers in 4 current and 3 expansion geographies
- Analysis of Nielsen data in the target's existing markets that established S-curve market growth pattern as Mexican population share of MSA's population increases; and building of an MSA-level market sizing model incorporating the S-curve equation to estimate the current and projected addressable market size
- Interviews with ~20 competitors to gain an understanding of top competitor strategies, including Tyson and Hormel
- Estimation of costs associated with starting and operating a second plant that would be required to capture the national expansion opportunity; and creation of detailed competitive database to identify potential acquisition targets in lieu of a greenfield plant.

\$1+B Addressable Retail Market Offers Significant National Expansion Opportunity

Based on grocery buyer interviews, consumer panel surveys, and Nielsen data analysis, Gotham established that the target performed well with desirable consumer segments such as Millennials and Hispanics and was well positioned in the growing refrigerated foods category. Our analysis indicated that the target's current markets were not yet saturated and a significant growth opportunity existed from growing ACV penetration and increasing marketing spend to drive mainstream consumers to this category. Moreover, given the similarities in demographics and consumer attitudes between current and expansion markets and demonstrated category buyer interest across all expansion markets, a significant growth opportunity was available from national expansion. In fact, Gotham's MSA-level market sizing model indicated a \$1+B addressable market, of which over 40% was still untapped, offering the target significant room for expansion.

Based on region-specific insights gained from Gotham's growth opportunity assessment, we identified 3 geographic areas East of the Rockies as the best candidates for geographic expansion and established that a 2nd plant in the middle of the country would be required to support national expansion. We established the one-time cost of setting up the 2nd plant and developed an operating cost model to understand its impact on the company's manufacturing and logistics costs. We also identified potential acquisition targets based on our detailed competitive landscape database and competitive segmentation according to size and production capabilities.



Additional Growth Opportunity From Expansion Into Foodservice

To pin down foodservice growth opportunity, Gotham interviewed ~30 buyers and distributors in the C-stores, restaurant, and K-12 channels. We established that the target has significant growth opportunity in the foodservice channel driven by: (1) growing movement from scratch cooking to using more cooked ingredients (heat-and-serve) in restaurants and school cafeterias; (2) growing Hispanic population; and (3) growing prepared foods sections in convenience stores. To quantify the foodservice opportunities, we built market sizing models for each of the 3 foodservice channels based on locations, population data, and market trends.

Limited Commodity Price Based Margin Risk With Room To Improve Margin From Yield And Throughput Opportunities

Gotham's operations assessment had 3 focal areas: (1) potential margin risks associated with commodity price fluctuations; (2) cost impact of the target's plan to convert temp agency employees to full-time positions; and (3) operations cost savings opportunities and risks. Leveraging the target's historical purchasing and sales data, Gotham was quickly able to determine that purchase prices were consistently in line with commodities prices and that the target has been able to pass through material cost changes to customers. As for the target's plan to convert temp employees into full-time employees, Gotham analyzed headcount and payroll data and found that the conversion would actually increase labor costs by 5%. Based on Gotham's overall operations assessment – including a detailed profile of the company's cost structure, recent cost trends, competitive benchmarks, and a 2-hour site visit – Gotham identified a 2-7% cost savings opportunity from material yield and throughput/labor improvement opportunities.

The Outcome: Gotham's fact-based assessment of the target's market and competitive dynamics established a ~\$2B addressable market opportunity, providing the target significant room for growth given its solid position with its customers and consumers. Our operational assessment identified material yield and labor savings opportunities. These fact-based conclusions gave the client the conviction needed to submit an aggressive bid to win this hotly contested auction.