

## Customer & Market Due Diligence Of Off-Road Vehicle Aftermarket Parts Supplier: Assessing Company Positioning And Market Outlook

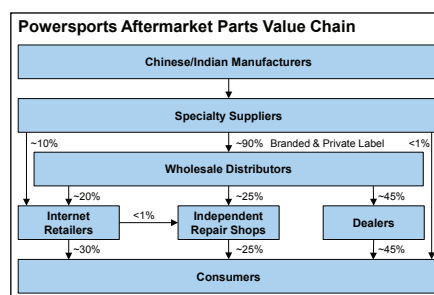
**The Challenge:** Our client, a large private equity firm, was engaged in a competitive auction for a specialty supplier of complex, low-volume off-road aftermarket replacement parts. The company was shifting away from its historical focus on the automotive/heavy duty aftermarket parts market and had rapidly built a position in off-road vehical aftermarket parts through acquisitions. The client was attracted by the target's impressive growth and the opportunity to create an industry-leading player in the fragmented off-road vehicle aftermarket parts market but was concerned about revenue sustainability, the lack of information on this off-road niche market, and some fundamental recent changes to the overall aftermarket parts market. The client engaged Gotham to ensure an informed bid by: 1) establishing the aftermarket parts market size/growth rates for key end-markets; 2) identifying potential threats from OEMs and from the elimination of steps in the value chain; and 3) understanding the eCommerce growth opportunity.

**Niche Aftermarket Parts Market Analysis:** To overcome what was essentially a complete lack of available information, Gotham undertook an intensive primary research and analytical effort to decipher this complex, fragmented market with its wide variety of players and changing value chain:

- Gotham conducted over 200 interviews, including ~40 interviews with decision-makers at major OEMs/distributors to understand their aftermarket parts strategies and ~160 interviews with dealers, repair centers, and retailers to gain first-hand market insights about part demand, buying behavior, and the impact of OEM/distributor strategies
- To establish aftermarket part market size and growth, Gotham first built a model to determine historical and future vehicle population and age distribution by leveraging historical/projected vehicle sales data and an EPA off-road vehicle scrappage curve – we then modeled aftermarket parts demand based on service requirements and part revenue by vehicle age/part type (e.g., rotating electrical, engine parts, gaskets, suspension, bearings)
- To gain clarity on the target's performance in specific markets and channels (the company had acquired 5 businesses in just 5 years, experiencing significant changes to distribution channels), Gotham analyzed the target's sales by distribution channel at the SKU-level, quantifying channel-specific market trends and determining that a key legacy channel was now in decline
- To establish the competitive landscape at each step of the value chain, Gotham developed a database of dealers/repair shops and profiled major distributors (revenue, private label brands, # of warehouses, # of SKUs) and OEMs (revenue, parts/accessories share of revenue, online parts sales, # of dealers, warranty) in the powersports, agriculture, and lawn & garden end-markets.

### **Demand Outlook Stable Despite Severe Drop In Off-Road Vehicle Sales During Recession And A Slow Recovery**

After a decade of dramatic growth in off-road vehicles, sales declined dramatically due to the recession and recovered very slowly afterwards. By piecing together market research and interview data, Gotham determined that slow off-road vehicle sales growth will persist in the medium term, driven by a relative lack of interest in motorcycles by younger consumers and a shift from ATVs to larger capacity UTVs. However, Gotham's market sizing model demonstrated that the decline in vehicle sales will only slightly impact the target's aftermarket part sales during the investment time horizon due to long vehicle lifetimes and the spike in vehicle sales preceding the recession.



### **Target's Ability To Manage Large Numbers Of Complex, Low-Volume SKUs Protects It From Competitive Threats**

To address the client's concern that OEMs might aggressively also go after aftermarket part market share, Gotham interviewed decision-makers responsible for aftermarket parts strategy at major OEMs playing in important end-markets: powersports (e.g., Harley Davidson, Honda, Suzuki, Polaris); agriculture (e.g., AGCO, CNH, Kubota); and lawn & garden (e.g., Husqvarna, MTD Products). While specific strategies varied by end-market and OEM, Gotham confirmed that OEMs focus on high-volume, low-complexity parts and not on the small-volume, complex service replacement parts that account for the bulk of the target's revenue. We uncovered similar strategies during interviews with major distributors (e.g., Parts Unlimited, Tucker Rocky, Western Power Sports, Rotary Corporation), where direct sourcing plans for private label brands also focus on high-volume parts, leaving the target a secure position within the value chain.

### **Shift In Channel For DIY Users Drives Growth In eCommerce, Reduces Target's Reliance On Distributors**

While the target's eCommerce sales were growing at a high double-digit CAGR, management did not provide a clear picture of its eCommerce growth drivers or the actual extent of its growth. Gotham's interviews with dealers, repair shops, and internet retailers established that, contrary to the ingoing hypothesis, the DIY end-user segment was not growing – vehicles are becoming increasingly complex and inaccessible to DIY consumers without advanced tools/expertise, and dealers/repair shops continue to prefer traditional channels for the ease one-stop ordering and the availability of volume discounts. Gotham determined that the key eCommerce driver was DIY customers (both consumers and commercial) shifting their purchases to online retailers. With this shift to eCommerce, online retailers gained sufficient volume to source directly from specialty suppliers vs. distributors. However, their sales were increasingly attributed to the online channel instead of the traditional distribution channel, thus exaggerating the eCommerce CAGR. While eCommerce growth was smaller than initially assumed, eCommerce's increasing prominence still offers important strategic benefits by decreasing the target's reliance on major distributors.

**The Outcome:** Gotham's intensive primary research and analytical effort provided a nuanced understanding of the market outlook and clarified threats/opportunities created by changing value chain dynamics in an information-poor market, thus allowing the client to make a well informed bid in a highly competitive auction.