

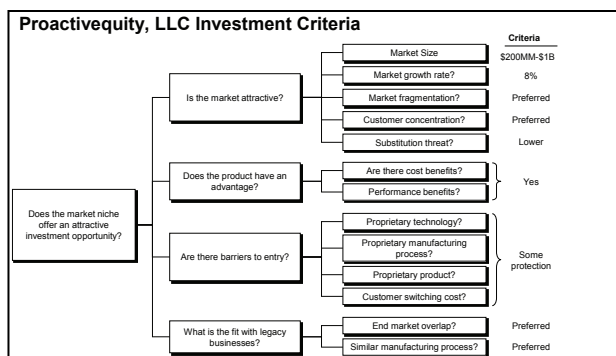
## Proactive Investment Strategy For Middle-Market Private Equity Firm: Investigating The Investment Potential Of 18 Industry Niches

**The Challenge:** A private equity group with approximately \$2B under management and a reputation for successful investments in U.S. middle market manufacturing niches, was facing an increasingly competitive PE market and a consequent dramatic shrinkage in the proprietary deal flow. In response to this changing environment, Proactiveequity initiated a new investment strategy centered around proactive analysis of a broad range of manufacturing niches for potential fit with its objectives. Within these niches, the firm’s overall criterion was companies with high growth potential, and in particular, those that had a strong competitive position in their specific market and that would enable Proactiveequity to leverage its existing industry expertise to the fullest. Gotham was brought in to assess 18 industry niches for their potential match with the PE firm’s investment criteria, as well as to advise the client on the overall suitability for investment in those niches.

### The Partnership:

**Investment Criteria:** Before beginning the niche investigations, Gotham worked closely with the PE client to flesh out its top-level investment criteria and, where possible, translate them into a set of quantifiable benchmarks for evaluating each industry:

- From a *market perspective*, the niche needed to generate \$0.2-1.0B in annual revenues. It needed to be growing at 8% per year (with double-digit growth preferred), in a relatively fragmented market with a relatively un-concentrated customer base.
- From a *product perspective*, the niche needed to demonstrate that market leadership could be sustained in part through proprietary technology/processes in the products or in manufacturing techniques, and that the products would enjoy low threat of substitution and, preferably, would be on a steepening adoption curve.
- From a *fit perspective*, the niche would preferably serve some of the same customers served by the PE firm’s existing portfolio of companies and/or would leverage some of the same manufacturing processes and techniques.



**Research And Analysis:** Over a 3-month period, the Gotham team conducted detailed studies of the investment opportunity for each of the 18 potential niches. Key to establishing a robust understanding of the inner workings of each niche was a detailed breakdown of the major aspects of each industry into market, player, and product elements.

- **Market:** Drawing on market research reports (where available), trade publications and associations, company news and information, and general media, we pieced together the size and growth of the industry, the key drivers of growth, threats to growth, and a full profile of the customer needs. Because the industry niches were usually very narrow, we often used bottom-up analytical techniques to model the market niches in order to fill in information gaps and/or to validate published claims.
- **Players:** To understand the competitive landscape of the industry, we studied the financials, business models, customers and market focuses, and core competencies of the key players in each niche, modeling their cost structures against each other where necessary to establish relative market shares and gain an understanding of each player’s key competitive advantages.
- **Products:** Understanding of the product/manufacturing advantages and disadvantages within a niche required in-depth analysis of the product variations available on the market, including any key product segmentation. We looked at differences in products in the context of any differences in manufacturing techniques or distribution or supply chain structures, so as to better understand both the cost and performance benefits of each product type.

**Reporting:** To facilitate a quick apples and apples comparative review, Gotham summarized our findings in one-page snapshots, with key trends, facts, and issues of concern highlighted in a similar format for each of the industry niches.

**The Results:** Of the 18 niches: 5 were considered “very attractive;” 7 “moderately attractive,” to be addressed at a later date; and 6 “unattractive,” precluding investment in the foreseeable future. The PE firm assigned the “very attractive” niches to their deal teams to pursue for investment, and is continuing to monitor the “moderately attractive” niches for possible investment in the future.