

## Customer & Market Due Diligence Of Technical Services Provider: Establishing Competitive Positioning And Demand Outlook

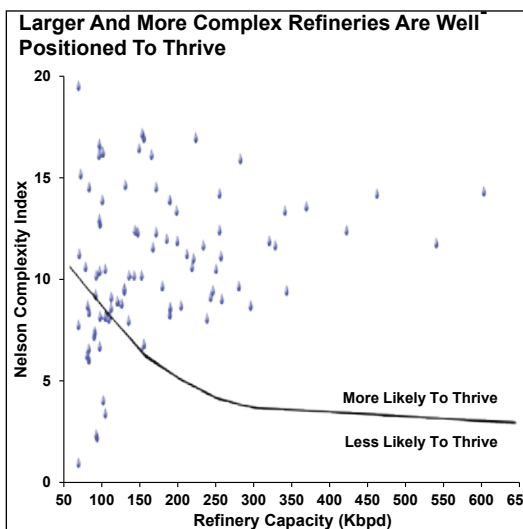
**The Challenge:** One of our PE clients was looking to invest in a provider of heat-treating services to refineries. While attracted by the target's market leading position and well-established relationships with refineries, our client was concerned about the refinery outlook in light of demand reduction for refined products due to EVs, as well as near-term demand outlook and pricing risk in light of COVID. As such, our PE client asked Gotham to conduct a 3-week customer & market due diligence to: (1) establish refinery outlook and on-site heat-treating services market dynamics/trends; (2) establish the target's competitive positioning/reputation in the heat-treating market and risk of commoditization; and (3) validate near-term project pipeline and long-term growth outlook.

**Refinery Market Outlook And Technical Assessment:** To address these objectives, Gotham undertook a multi-pronged approach that entailed:

- Conducting 38 anonymous interviews with refineries, petrochemical companies, contractors, and fabricators to gain insights into on-site heat treating services, refinery decision-making criteria, competitive landscape, and target's reputation/positioning
- Establishing the refinery market outlook by analyzing refined product demand (by PADD region and exports), refinery production, capacity utilization, plant retirements and consolidation, COVID-related shutdowns, refined product transportation network, and the impact of environmental regulations on refined production mix; we also established a refinery-level view of turnarounds
- Analyzing the target's sales history and projections to: profile the target's customer/project mix and project profitability by end-market (e.g., refinery, petrochemical), channel (direct vs. contractors), and project type (turnaround, new construction); establish the target's customer concentration and impact of COVID; and identify jobs by refinery to validate the target's near-term pipeline
- Researching technical specialization and ASME code requirements to gain a thorough understanding of the technical nuances, understand the skills relevant to implement these codes, and evaluate the target's performance relative to these codes
- Establishing the competitive landscape by segmenting players into 9 different categories by services provided, by PADD region, by technology and equipment used, and by size; also profiled 35 heat-treating companies
- Assessing heat treating market growth potential by: developing bottom-up heat-treating market sizing model; determining key demand drivers in the next few years within LNG Export, Chemical, and Natural Gas Power Plant end-markets; and analyzing potential growth opportunities in current and new geographies and within NDT/NDE and maintenance & repair services.

### **Refinery Outlook Is Stable As Expected Decline In Domestic Refinery Product Demand Is Offset By Growing Exports**

Gotham established that domestic refined petroleum product demand is declining, driven by an increase in vehicle fuel efficiency and a shift toward electric vehicles. However, production output has remained stable as increasing exports offset declining domestic consumption. These demand trends along with crude supply/pricing dynamics and environmental regulations are leading to refinery consolidation as refining companies try to achieve economies of scale and optimize their asset base. This consolidation trend has resulted in increased capacity for large refineries and the closure of 31 small refineries, with 52 large refineries (out of a total of 130 refineries) now accounting for 75% of total U.S. refining capacity. Gulf Coast/PADD 3 (54% of total capacity) is becoming a refinery hub as it has access to Permian Basin, Gulf, and waterborne crude supply; East Coast refining capacity is non-existent as product pipelines are delivering refined products from Gulf Coast; Midwest refineries are shielded from closure due to lack of product pipelines; Rocky Mountain region has an uncertain future even with local crude; West Coast refineries are facing a challenging future due to EV mandate and carbon-free economy goal.



### **Target Has A Strong Competitive Positioning With Solid Reputation For Quality And Technical Skills**

Gotham established that the target is one of the top three players in the market with its strong brand presence and it ranks better than the other 2 players on key customer selection criteria – quality, availability, and safety. Heat-treating players comprise: pureplay heat-treating companies like the target; NDT/NDE providers; and multi-service providers. Our assessment confirmed that the target offers highly specialized technical services requiring a high level of technical skills (control of heating, soaking, and cooling cycle dictates heat-treating outcome), with these requirements unlikely to be ever commoditized. The ASME Code demands preheat and post-weld heat treatment for performing welding on pressure vessel and piping and any quality issue can lead to high cost of failure with safety and environmental repercussions. The target has quality technicians and long-standing relationships – the most important criteria for customers – and, as such, they are unlikely to switch service providers to gain lower prices.

### **Target Has Multi-pronged Geographic, Service Line, And End-market Expansion Opportunities**

Gotham established that the target has potential to further solidify its position in the Gulf Coast via consolidation and the Midwest is a potentially appealing expansion region but lacks pureplay heat-treating acquisition candidates. Within the target's existing customer base, maintenance & repair services offer incremental growth opportunities. Gotham established multiple end-market expansion opportunities: LNG export terminal investment, significant chemical plant development activity because of shale revolution, and the construction of 200 natural gas power plants during the next 7 years will create additional demand for target's services.

**The Outcome:** Gotham's fact-based approach provided our client with a clear understanding of the refinery market outlook and confirmed the target's competitive positioning as the leading player in the market. We also gave our client confidence in the near-term revenue outlook by validating the target's project pipeline and confirming that the high skill requirements preclude a pricing risk.