Customer & Market Due Diligence Of Electric Utility Services Company:
Assessing Customer Risk, Margin Sustainability, And Growth Opportunities

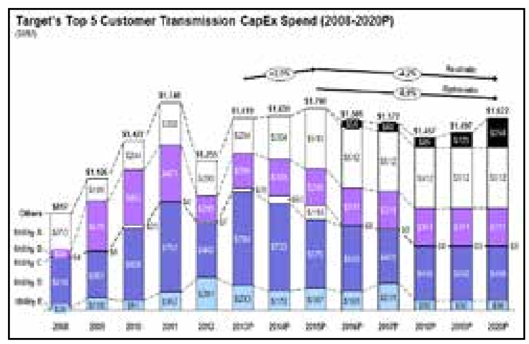
The Challenge: Our client, a large energy-focused PE firm, was considering an investment in a leading regional electric utility services company with the objective of creating a super-regional player. The privately held target had shown substantial margin improvement over the past 2 years, benefiting from significant regulation-driven investment in transmission and distribution (T&D) system upgrades and repairs. However, despite this recent performance, our client was concerned with the target's high customer concentration risk (over 60% of its revenues tied to 5 utilities), the sustainability of its high margins, and its ability to expand outside its core 6-state geography. To address our client's investment concerns, Gotham conducted a 2-phased customer & market due diligence, with the pre-bid 2-week Phase I focused on evaluating revenue risk and margin sustainability around the target's core business, and the subsequent 2-week Phase II focused on assessing geographic expansion opportunities.

Revenue/Margin Sustainability & Geographic Expansion Assessment: For Phase I, Gotham conducted a comprehensive review of the target's top customers through: (1) analysis of T&D CapEx and Operations & Maintenance (O&M) spend data, leveraging a proprietary database of utility line projects and publicly available financial and regulatory filings (e.g., SEC, FERC); (2) 30+ interviews of key T&D customers; (3) analysis of available data room information, including a detailed jobs database and forecast; and (4) additional primary and secondary research and analysis (e.g., profiling target's key competitors). After our client won the auction, we then conducted similar analyses of the largest utilities in surrounding states to develop a geographic/ super-regional expansion strategy (Phase II).

T&D CapEx At Top Customers Declining And Tapering Off Over Next 5 Years, But Target Well Positioned To Maintain Share

Beyond leveraging the data described above, to assess investment risk associated with target's customer concentration in its core region, Gotham built a bottom-up, project-level model of each customer's T&D CapEx spend (by project type, line-mile spend, start/end date, etc.) and fine-tuned our 8-year projections by working hand-in-hand with leading industry experts. We found:

- Recent growth in T&D CapEx driven by: higher transmission line reliability standards, with FERC Rule 1000 easing hurdles for utility investment in line upgrades; replacement of an aging grid infrastructure (70% of transmission lines and transformers are 25+ years old and 50% of distribution lines are 30-50 years old); and a shift from coal-fired generation to cleaner energy sources (i.e., natural gas and renewables)
- Minimal risk of the target losing share with top customers, as interviewees indicated the target has a favorable reputation (viewed as good to work with) and is well-positioned to win bids on future work ("preferred vendor" status)
- Despite favorable market dynamics and target's positioning, near-term CapEx growth would be ~3% at the target's top 5 customers and projected T&D spend under both realistic and optimistic scenarios would taper off after 3 years, coinciding with the expiration of reliability-driven requirements.



Target's High Margin Likely To Be Dampened In A Few Years When Spend Declines/Flattens

To assess the sustainability of the target's margins, which are significantly higher than those of leading competitors (EBITDA margin of over 25% vs. 6-11% for competitors), Gotham conducted a deep-dive into the target's customer job-level P&L data. Our analysis of 5 years of historical data revealed that the target benefited from a favorable mix of more lucrative fixed price projects (vs. time-and-material contracts) and a significant amount of billed overtime hours driven by an increase in overall demand. Furthermore, due to this increase in demand and the target's favorable positioning (distinguished from competitors by its ability to manage complex projects, e.g., rough terrain work), the target was able to "cherry-pick" higher margin projects. However, as projected CapEx declines over the next 5 years and as some high-margin projects end, Gotham anticipates the target will face greater challenges in securing these higher margin projects and sustaining current margin levels.

Potential For Target To Expand To 11 Adjacent States And Become A Super-Regional Player

To support our client's thesis of creating a super-regional player, Gotham investigated geographic expansion opportunities in contiguous states both, north and south of the target's currently served market. Our initial research confirmed a continuing outsourcing trend, with leading utilities in the targeted states leveraging outside contractors for over 80% and 50% of line upgrade projects on the transmission and distribution sides, respectively. Recent lineworker retirements and cutbacks to in-house apprenticeship programs had created a scarcity of skilled utility resources, fueling this outsourcing growth. Furthermore, through our targeted interviews and project-level analysis of 17 major utilities in the 11 expansion states, Gotham established:

- **Southern expansion:** the target is well-positioned to penetrate this fast-growing ($13.5B projected 5-year CapEx) region due to pre-existing relationships with many of the region's utilities through storm-related work and the presence of non-union utilities
- **Northern expansion:** although utilities to the north are projected to have large upgrade requirements (over 1,700 new and upgraded transmission line miles between 2016 and 2020), due in part to storm-hardening in the aftermath of a major hurricane, penetrating these utilities would require the adoption of a union workforce (a contractor prerequisite for many of the utilities).

The Outcome: Based on Gotham's due diligence findings on the target's core business performance and outlook, our client won the auction at a more favorable valuation (some 30% lower than client's initial valuation). Armed with Gotham's projections for utility T&D CapEx spend and our Phase II analysis on the target's growth opportunities, our client successfully closed the transaction.

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