

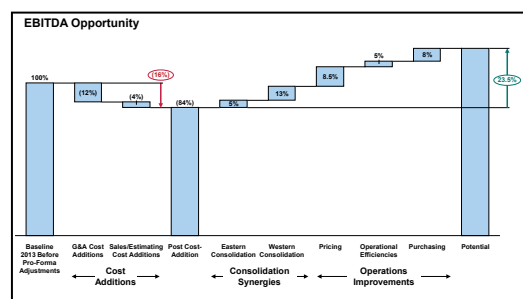
Operational Due Diligence Of Testing Services Provider: Identifying Synergies From And Operations Opportunities In An Add-On Acquisition

The Challenge: Our client, one of the largest testing services providers in the U.S., was seeking to acquire a non-core testing division of a large technical solutions provider in order to expand its footprint in an important region in the east, gain scale in the west, and strengthen its presence in the nuclear end-market. Our client also believed that there was a consolidation opportunity in the west. Management was familiar with Gotham's work from our operational due diligence of their company, and asked us to conduct operational due diligence of this add-on acquisition to: identify and quantify facility consolidation and other synergies; determine cost additions required and operations improvement opportunities; and establish current asset and labor utilization.

Add-On Consolidation Synergy And Operations Improvement Assessment: As the target was a direct competitor of our client, access to operational and financial data was very limited. Consequently, Gotham had to supplement the limited information in the data room with our observations from site visits and our prior experiences in service operations to develop a meaningful view of the target's operations. We first generated a robust operational cost fact base by cleaning 3 years of trial balances, validating data against financial statements, reconciling adjustments to address variations, mapping each cost item onto conventional operational groupings (direct vs. indirect; material, labor, and overhead), and allocating costs to test types within each facility. We then developed a comprehensive capacity fact base (by equipment/testing capability type, age, replacement cost, utilization, etc.) that incorporated details from our site tours and management discussions. Finally, working hand-in-hand with our client, we were able to use this baseline to test several hypotheses on synergy and operations improvement opportunities.

12% EBITDA Gains Achievable Through Site Consolidation

To assess the feasibility and economics of the potential consolidation opportunity identified by management, Gotham: mapped testing capabilities at 2 facilities and identified capability overlaps; profiled each employee by function and position, including, direct vs. indirect role, salary, and benefits; and detailed overhead expenses by function and expense type. We identified 3 potential consolidation options: 1) management consolidation only; 2) management consolidation with transfer of select testing capabilities; and 3) complete consolidation with closure of 1 facility. For each option, we established savings by analyzing each labor and overhead cost element to determine if it needed to be transferred, as well as one-time costs, to provide



our client information required to make consolidation decisions post-acquisition. We also identified an opportunity to consolidate our client's nuclear testing facility into target's larger, more capable facility. After reviewing that opportunity, management agreed with our assessment and asked us to conduct similar consolidation analysis to establish labor and overhead savings, as well as one-time costs. Our analysis indicated 12% EBITDA improvement potential from these consolidation opportunities.

22% Margin Enhancement Opportunity Through Operations Improvements

Leveraging the operational cost fact base, as well as data from Gotham's previous operational due diligence of our client, we conducted detailed operations benchmarking of the client and the target. Our margin analysis of comparable facilities (by testing capabilities and size) revealed that our client had a 22% higher gross margin than the target. To understand the root causes of this margin differential and identify EBITDA improvement opportunities, Gotham:

1. Analyzed pricing at each facility by job type and found that more than 80% of the target's revenue is lower margin jobs. Whereas our client had a centralized sales and marketing function with a dedicated pricing team and commissioned sales force, the target managed these functions at the local site or even at a testing department level where these responsibilities were absorbed by engineers. We estimated that by implementing the client's sales & marketing model and more opportunistic pricing across the target's facilities, an 8-18% EBITDA improvement was possible.
2. Analyzed labor and overhead cost structures and determined that the target paid higher salaries than our client for similar positions, had a higher engineers-to-technician ratio, and had higher facility costs. By achieving operational efficiencies to our client's benchmark levels, target can improve EBITDA by 3-4%.
3. Benchmarked target's purchasing practices against our client's and established a 7-10% EBITDA improvement opportunity.

We also determined that the target had sufficient labor and asset capacity to handle the anticipated increase in volume from our client's sales and marketing approach without requiring additional CapEx and leading to further increase in the target's margins.

5% Addition To Our Client's G&A Cost Base Required To Support The Target's Operations

Since G&A support to the target was managed centrally by its parent company, Gotham quantified the additional G&A cost required to replace this support. To this end, we mapped our client's current G&A organization and cost structure by function (Finance, HR, IT, Legal, etc.), establishing benchmarks of key G&A cost metrics (FTE, per lab, revenue, etc.) for each function. Then, based on the target's operational metrics, we established additional G&A staffing and cost required to support target's operations – a 5% addition to the client's G&A cost base to support an approximate 25% additional revenue and employee base. We also estimated the one-time costs for IT system transition and upgrades, new employee training, and marketing collateral development.

The Outcome: Gotham's due diligence findings provided our client a solid understanding of the operational value from the potential acquisition and highlighted integration challenges. Our client used the detailed cost fact base developed by Gotham to build financial projections of the target. Armed with a reliable fact base and opportunity assessment, our client was able to move on the acquisition with confidence and has already begun capturing synergies identified from our due diligence.