Proactive Investment Strategy For MIddle-Market Private Equity Fund: Identifying Target Specialized Manufacturing Industries For Investment

The Challenge: InvestEquity, a middle-market private equity firm, was in the process of raising its 3rd buyout fund, targeted at \$500MM. InvestEquity believed that the investment boom in emerging economies would drive growth for specialized manufactured products, with the next 24 months presenting a significant opportunity to invest in its 4-5 related platform companies. Gotham had an ongoing relationship with InvestEquity, having assisted in developing an investment strategy for its previous fund 4 years ago and was asked to help validate the firm's ingoing hypothesis vis-à-vis specialized manufacturing and identify a shortlist of the most attractive industries for potential investments.

The Partnership:

<u>Investment Criteria</u>: Gotham met with the firm's investment team members to review the hypothesis and preferred profile of its portfolio companies. From these discussions, we identified four investment criteria: (1) strong relation of products to the investment boom in emerging economies; (2) innovative and critical products that can command/maintain high margins; (3) companies that are not susceptible to local competition and will be able to export their products and expertise from the U.S.; and (4) companies based in InvestEquity's target geographies.

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Key investment Criteria	Category 1	Category 2	Category 3	Category 4	Category 5
High Infrastructure Applicability	•	•	9	•	٠
Defensible Sector	•	٩	9	٠	0
Favorable Industry Dynamics	•	•	0	•	٩
Attractive Geographic Location	•	0	•	•	4

Research And Analysis: Gotham worked closely with the investment team to identify target industries by:

- 1. Establishing investment trends for 25 key investment sectors: Top-level assessment to: understand the 10-year forecasted investment trends in each sector; determine major products used in each sector; decipher the key technology trends to understand future demand in each sector; and rank these sectors and quantify their global growth potential. Key information sources included: analyst reports, publicly available information on key players in these markets, and interviews with industry experts.
- **2.** *Identifying industries that would benefit from investments made in these sectors:* Analysis of 22 industries against InvestEquity's investment criteria:
 - Relevance of products to the investment boom: leveraged available data from government sources (e.g., U.S. Census Bureau) to identify the usage profile of product categories and size/ratio of their demand coming from the target investment sectors.
 - Defensible characteristics: analyzed specific applications of the products within identified sectors, the requirements for innovation and complexity (and associated characteristics), indicating defensibility (e.g., low material cost and high number of engineers/skilled trades in the workforce).
 - Favorable trade dynamics: reviewed current players in each sector and assessed likely sustainability
 of niche players; established key trade-related metrics such as low import intensity, high export ratio,
 and domestic to international sales ratio.
 - Attractive geographic location: determined geographic location of companies in the target industries vis-à-vis the client's target geographies.
- **3. Short listing target industries:** Ranked investment sectors and target industries and narrowed the focus to 5 investment sectors and 5 industries that offered the best opportunity vis-à-vis the client's investment criteria.
- 4. **Profiling short-listed industries:** Took a deeper dive into the short-listed industries to pin down key products that would benefit from the identified global investment boom in the target investment sectors. Identified critical components and principal equipment manufacturers, interpreted market trends, estimated market size for critical components, and then identified the target acquisition candidates for the most promising product categories.

Outcome: InvestEquity exceeded its fund-raising target, closing a \$500+MM fund within a few months. The firm is now actively seeking acquisitions in the identified industries.