

Customer & Market Due Diligence Of Engineering Consulting Firm: Validating Market Opportunity To Create A Super-regional Player

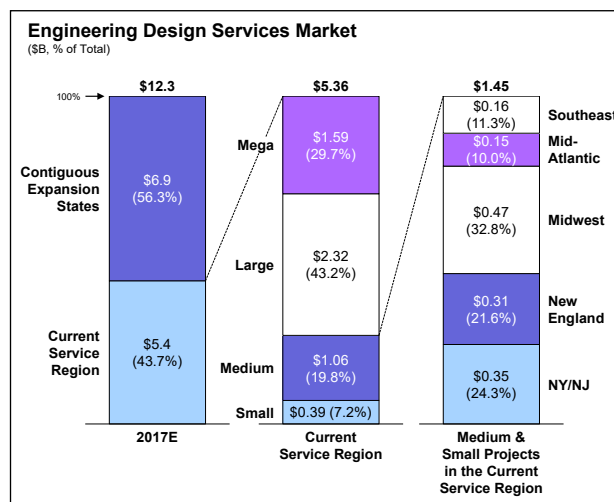
The Challenge: One of our PE clients was considering an investment in an engineering consulting firm primarily operating in the Northeast, with potential to become a super-regional player in the Eastern U.S. Our client was attracted by the target's strong local relationships and vast array of capabilities, as well as by its diverse end-market mix (e.g., highways & streets, aviation, rail & mass transit, utility infrastructure, water/wastewater, manufacturing, facilities, sports & entertainment). Wanting to confirm that the target was a solid platform with acquisition targets available to create a super-regional player, our client asked Gotham to conduct a 4-week customer & market due diligence to establish the: (1) engineering services market size and growth outlook by state and by end-market; (2) target's reputation and competitive positioning; and (3) target's growth opportunities.

Geographic Expansion Opportunity Assessment: To address our client's due diligence objectives, Gotham undertook a comprehensive, multi-pronged effort that entailed:

- Conducting 100+ interviews and 100+ online surveys with engineering services customers in core geographies and end-markets to understand: engineering services demand drivers and outlook; construction spending dynamics; customers' buying behavior; competitive landscape; the target's reputation and positioning; and service line expansion opportunities
- Building a bottom-up market sizing model using Dodge construction activity data to establish market growth trends and market share by end-market and state, as well as backtesting the target's sales mix to determine potential impact of a recession on the target's business
- Establishing market dynamics in the target's key end-markets by profiling spending trends, funding dynamics, and outlook
- Analyzing over 1,475 engineering services firms to develop a comprehensive view of the competitive landscape and acquisition opportunities in target's end-markets across current and expansion geographies.

8-9% Organic Growth Opportunity With Limited Recession Risk Due To Small And Mid-size Product Focus

Gotham's market sizing model estimated the construction-related engineering design services market to be ~\$12B in the target's geographies and end-markets, of which small to medium size projects accounted for a healthy 27%. While the target's served market was expected to grow at 3.1% CAGR, Gotham estimated that the target would achieve higher (4.5%) CAGR growth due to its favorable end-market/geographic mix. The target could add another 2.8% CAGR growth by growing its market share from 0.85% to 1% with a renewed focus on business development and cross-selling. The target's exposure to infrastructure spending and its focus on small to medium size projects limit its recession risk (demand for alteration projects actually increased during the 2008/2009 recessionary period). Simulating the target's sales by end-market through a 2008-2009 magnitude recession indicated only a 10-15% sales decline in its engineering consulting business. Most customers indicated price increases of 3-4% are a norm that is expected to continue, creating an opportunity for the target to drive margin growth in the future.



Target Has Solid Reputation And Longstanding Relationship With Its Customer Base

The engineering services market is fragmented with hundreds of players, including large national firms, mid-size firms, and small players – and the target is a leading regional player. Large national players focus on large projects leaving mid-size projects to mid-size firms like the target, and local knowledge of regulations, procedures, and key stakeholders constitutes an opportunity for the target to entrench itself. Small firms cannot typically compete beyond a narrow scope of work, limiting their ability to go after mid-size projects. Gotham's extensive interviews and surveys revealed that the target had strong customer loyalty in an industry where familiarity and track record are critical, indicated by the target's above-average NPS score.

Acquisition-driven Growth Opportunity To Create A Super-regional Player

Gotham conducted a rigorous analysis to identify future acquisition targets for our PE client. First, we scored and ranked end-market/state combinations across three dimensions – market size, market growth and target profitability – to identify the most promising acquisition focus areas. We used these rankings to inform our analysis of 1,475 engineering services firms in states contiguous to the target's current geographies, as well as of players that are end-market focused. Gotham shortlisted 110 potential acquisition targets across nine states, confirming availability of plenty of acquisition targets to build a super-regional player. Gotham identified water/wastewater as an attractive end-market across multiple states and shortlisted 42 water/wastewater-focused companies of different sizes and across different regions that represent acquisition opportunities for the target.

The Outcome: Gotham's comprehensive assessment of the target's market and competitive dynamics provided our client with facts necessary to be comfortable with the target's positioning and acquisition-driven expansion opportunity and compete aggressively in a hotly-contested auction.