

NORTHLIGHT

# BEACON FOR GROWTH 1.2

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## Market Power Assessment – A Powerful Add-On to Due Diligence

*You have three weeks to put the bid together. You already know that you are going to pay 30-40% higher multiples on the acquisition – an abundance of “dry powder” coupled with low interest rates has ensured that. As always, your central challenge is to make sure that the asset is going to generate a higher IRR for your investors. But in today’s market you want your investors to have the confidence that you can hit the ground running because of the exit optionality it offers.*

Given this urgency, leading Private Equity firms are adding a new dimension to their “traditional” financial, operations and commercial due diligence in the form of an upfront rapid “Market Power Assessment” (MPA). They view this rapid opportunity identification not only as an important tool to assess the value/price of the asset at the time of purchase, but also as an integral part of the value generation plan in its early life after acquisition.

MPA identifies market areas where there is “low hanging fruit” that could potentially drive both growth and EBITDA within the first 3-6 months and prioritize the longer-term value creation agenda. There are three key elements typically included in a rapid MPA that could be integrated with any due-diligence assessment.

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# 1 | PRICING POWER

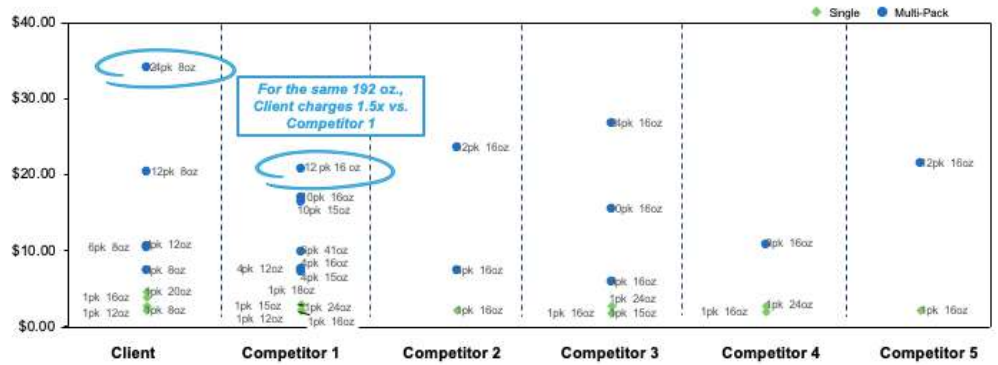
This element focuses on identifying quick fixes in pricing inefficiencies and sub-optimal pricing practices typically found in smaller privately owned companies – which often lack consistent access to the necessary data and analytics. For example, Exhibit 1 shows a mismatch in pricing relative to competition for a PE owned beverage company where some products are priced far higher than its competitors (who offer very similar products) – lowering these price differentials could drive short-term growth.

Second, it also identifies inefficient price-deal behavior – i.e., discounts and promotions that dilute margin but do not generate enough volume for the company. Those deals need to be eliminated in exchange for more productive ones.

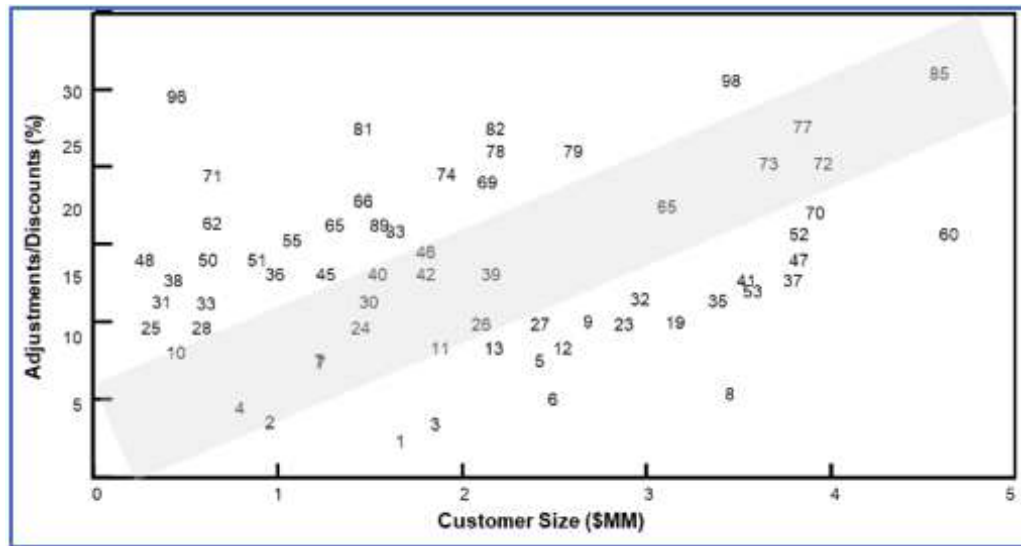
Finally, it examines pricing rationale by customer size/strategic importance and identifies outlier customers that are outside the “rational band” of pricing. Exhibit 2 shows several customers of a PE-targeted technology company who are given high level of discounting – realigning the pricing for these customers could increase margin in the short-term.

These are some of the near-term opportunities that can be identified during the due diligence process. While adjustments to the broader pricing strategy could take time, Pricing Power assessment can identify immediate, actionable opportunities.

**Exhibit 1: Assessing Price Differentials**



**Exhibit 2: Assessing Pricing Tactics**



## 2 | PRODUCT POWER

Here, the focus shifts to the low hanging fruit around unprofitable/low-performing products within the asset's portfolio, which often exist due to organizational legacy, founder's preferences and other factors. Product Power assessment includes a top-line evaluation of each brand based upon four potential criteria – (a) historical performance, (b) strategic importance, (c) contribution margin and (d) growth potential. Exhibit 3 shows that a potential acquisition target (in the household cleaners' space) was able to drive price premiums over the past two years with Products 1 and 2 – a reflection of their brand equity. However, Product 5 within its portfolio has been forced to reduce price mainly due to the growth of Private Label within the category and it not having the same brand power as the other products. Realigning the product and customer mix was able to impact margin for the company.

This approach, while capturing the close-in opportunities, provides an excellent basis for the deep dive into the portfolio which will follow.

## 3 | CUSTOMER POWER

The final element focuses on identifying customers with low or declining profitability. Too often customers are served or retained without regard to (a) what it costs to serve them, (b) what is the actual realized profit from them and (c) what their specific product mix should be. There is real money in getting that right.

It also dives into customer churn and customer retention and identifies immediate opportunities to drive higher customer value. Finally, it identifies under-served customer and segments which can be a focus on an immediate basis.

Exhibit 4 shows a due-diligence assessment for a B2B manufacturer selling to grocery and auto retailers. Customers are segmented based upon growth, margin and strategic importance. Post-acquisition the company focused primarily on growing its strategic and high margin customers while de-emphasizing low-growth, low margin ones.



# CONCLUSION

In the current, highly competitive deal environment, a rapid MPA can substantially enhance the short-term value creation effort by identifying actionable near-term opportunities to drive both revenue and EBITDA. Leading PE firms have embraced MPA not just to evaluate and right-price the asset but to lay the foundation for growth and EBITDA improvement in the first 180 days after acquisition.

**Exhibit 3: Assessing Product Power**



**Exhibit 4: Assessing Customer Growth/Margin**

Tier 1 (Strategic, High Growth, High Margin)			Tier 3 (Low Growth, Low Margin)	
Customized (44%)		Strategic Grocery (12%)	Merchandisers (5%)	Operators (5%)
<ul style="list-style-type: none"> <li>Wal*Mart (22%)</li> <li>Target (5%)</li> <li>Dollar (4%)</li> </ul>	<ul style="list-style-type: none"> <li>Club (13%)</li> </ul>	<ul style="list-style-type: none"> <li>Albertson's</li> <li>Kroger</li> <li>Safeway</li> <li>SuperValu</li> </ul>	<ul style="list-style-type: none"> <li>Associated Wholesale Grocer</li> <li>Basha's</li> <li>Great A&amp;P Tea Co</li> <li>Hy-Vee</li> <li>Roundy's</li> <li>Stater Brothers</li> <li>Unified Western Grocers</li> <li>White Rose</li> <li>Winn-Dixie</li> </ul>	<ul style="list-style-type: none"> <li>Alex Lee</li> <li>American Food Service</li> <li>Grocers Supply</li> <li>Jetro</li> <li>Military</li> <li>Nash Finch</li> <li>Ruddick</li> <li>Spartan</li> <li>SSI</li> <li>Telmark</li> <li>United Stationers</li> </ul>
Tier 2 (Important Regional, High Margin, Slow Growth)				
Marketers (4%)	Merchandisers (10%)	Specialty (5%)		
<ul style="list-style-type: none"> <li>HEB</li> <li>Publix</li> <li>Wegman's¹</li> </ul>	<ul style="list-style-type: none"> <li>Ahold²</li> <li>Food Lion/ Hannaford</li> <li>Giant Eagle</li> <li>KMart³</li> <li>Meijer</li> <li>Wakefern</li> <li>C&amp;S</li> </ul>	<ul style="list-style-type: none"> <li>Auto                             <ul style="list-style-type: none"> <li>Advanced</li> <li>Autozone</li> </ul> </li> <li>Pet                             <ul style="list-style-type: none"> <li>PetSmart</li> </ul> </li> <li>Drug                             <ul style="list-style-type: none"> <li>CVS</li> <li>Walgreen's</li> </ul> </li> <li>Home/Hardware                             <ul style="list-style-type: none"> <li>Home Depot</li> <li>Lowe's</li> <li>Ace Hardware</li> </ul> </li> <li>Dept. Specialty                             <ul style="list-style-type: none"> <li>Bed Bath Beyond</li> <li>Kohl's</li> <li>Linens N Things</li> </ul> </li> </ul>		

NorthLight Analytic Partners is an analytics firm focused primarily on helping Private Equity Firms and their Portfolio Companies achieve growth via advanced analytics and technology. We work closely with these firms to build and implement these capabilities and gain marketplace advantage. For more details, please go to [www.northlightanalytics.com](http://www.northlightanalytics.com) or email [info@northlightanalytics.com](mailto:info@northlightanalytics.com).