

Ten Years after 'The Big One'

Some Thoughts on the Next Wave in Heavy Duty Parts & Service Consolidation





Sheraton Hopkins, SSA Meeting, 1998 Saturday Morning

The basic premise couldn't have been any simpler:

- Highly fragmented industry;
- Facing technological change;
- Customer upheaval;
- Chronic financing difficulties.

SSA Meeting, 1998

- Add in financial firms or (worse) a couple of unknowns from “outside the business”;
- **Industry leaders are family businesses (second or third generation)... with limited succession plans...**
- The next step to protect profit and continue growth was clear: **Consolidate.**

SSA Meeting, 1998

It couldn't miss. **The new company would start out life with the best of everything –**

- Smart, entrepreneurial ex-owners as key managers;
- Freshly infused capital from public or private equity;
- Savvy top management eager to reap the “low hanging fruit” by combining back offices, systems, inventory, purchasing power and expanded customer contact.

The difference 'this time' ... Is that there was a 'last time'.

It is ten years later...

- Owners who missed or opted out of the 1998 tsunami are ten years older.
- **The average age is in the sixties.**
- The interest in acquiring HD distributors had a time limit. Transcom crashed, causing terrible costs to great family businesses, the idea of non-cash combinations died completely.



The difference 'this time' -

- Obama admitted that a tax rate increase might lose revenue, but has held firm that the capital gains rate should be increased from **15 percent to 28 percent**.
- Even the hint of such an increase is enough to push reticent sellers to the table. In the 2008 version, it will be a **'cash-is-king'** mentality, but
- Offers will probably be from industry players, not from pure private equity financial investors.

Factors Driving Today's Market:

- Private business owners in the 55-plus age bracket looking to sell;
- Foreign buyers taking advantage of currency trends ;
- An abundance of private equity money that still needs to be invested ;
- **Strategic buyers are looking for value acquisitions.**



Welcome to the real world!

Independents, Groups or Consolidations...



There are no unserved NAFTA markets...
Free rides are at a premium

Credit Crunch Be Damned

There is funding to complete acquisitions on *the same general scale as the last time.*



Insiders... Possibilities from within the Heavy Parts Industry

FleetPride- The recent purchase of Keller Truck Parts signals the interest and means to build through further large purchases.



Insiders... Possibilities from within the Heavy Parts Industry

Very Large Independents-

Inland, Crane Carrier or TruckPro know well how to play this game.



Insiders... Possibilities from within the Heavy Parts Industry

Very Large Independents-

Crane Carrier, Palmar or TruckPro could also be **large sellers**



Insiders... Possibilities from within the Heavy Parts Industry

Truck Dealers- Big guys like Rush or Worldwide may find expanding in service and parts faster through the 'buy' route than thru the 'build' process;



Insiders... Possibilities from within the Heavy Parts Industry

All Makes OES Operations- Truck makers have long bemoaned the lousy percentage they get of the parts side... and the costs of adding more service capacity.



Outsiders... Distributors Who Need to Find Greener Fields

NAPA- Announcements of a Traction-modeled approach (with the recent Brake Service purchase) shows that they serious about becoming the “NAPA of the HD Business”.



Outsiders... Distributors Who Need to Find Greener Fields

Carquest- Especially with their experience in 'joint venture' style acquisitions that are designed to keep existing personnel involved.



Outsiders... Distributors Who Need to Find Greener Fields

Industrial Crossovers- Grainger, Fastenal and others have developed sophisticated systems that would probably fit the HD business beautifully.



Valuation

- This time, strategy trumps all.... It won't be a case of 'how much is my place worth' (EBITDA times some magic multiple)... rather 'how much is it worth **To Whom and Why.**
- Strategic interest may come from pursuit of the mythical 'national footprint' ... or from the presence of **bench or on-vehicle service** in distributor locations.

Valuation

- **Service will elicit a premium price this time.**
So will locations that fall logically into an acquirer's logistical map for customer service or branch inventory support.
- The importance of keeping talented players (especially at the branch level) is certainly one of the key lessons from 1998.
- **Operations with stable, well trained employees will find themselves on top of the target list.**

The Role of Groups

- Groups exist as a form of **virtual consolidation**.
- They offer suppliers and widely dispersed fleet customers many of the benefits of a consolidated service channel...

without the distributor having to survive the emotionally wrenching family issues and expensive legal sale question.

The Role of Groups

However, successful acquirers as diverse as **FleetPride, Motion Industries and O'Reilly** have proven the absolute strength of an equity combination...

an **unbeatable model** of continued profitability, operational control and shareholder value growth.



The Role of Groups

- **Consolidations can vastly reduce the marketing clout of groups**, as the better players tend to be the prime targets.
- This time may be Vipar's turn in the barrel... they have a disproportionately large membership among the targets ... **Even an extremely well run group can't out duel a pile of cash.**
- There may be only one important marketing group left... but it will be much different than the four or five today.



The Future Landscape



- **Four** integrated HD truck makers;
- **Five** full range trailer builders;
- **Three** heavy engine choices;
- **Six** major truck equipment dealers;

The Future Landscape



- Five large HD distribution chains;
- Three OES parts only spinoffs;
- Two Internet –based parts expeditors;
- One super marketing group;
- **75 % of today's independent parts & service providers...**

The Future Landscape



...servicing the 75 top 100 (2008) fleets that survive the fuel, labor and regulatory shakeout...

as well as then environmentally compliant local vocational and municipal truck operators.

If It Were So Damned Simple, They Wouldn't Need Us!

Ten years later, we still have...

- A highly fragmented industry;
- Facing technological change ...
 - to the products carried
 - to technology that delivers parts
 - to train people to diagnose and service
- Customer economic and regulatory upheaval;
- Chronic financing difficulties.



If You Decide to Sell, Which Strategies Might Work ?

**Become insanely profitable with
monopoly market power...**

But then why sell?

Price = \sum Future Cash Flow x NPV x BS Discount

Or

EBITDAAI x Market Expectation Multiple

If You Decide to Sell, Which Strategies Might Work ?

- Create a **Larger Footprint** Internally
 - Geographically
 - Specialty Parts & Services
- Create a **Larger Footprint** Externally
 - Acquisition
 - Partnership / Joint Venture

If You Decide to Sell, Which Strategies Might Work ?

- **Sell & Walk Away** (Price Implication?)
- Create a Larger Footprint Internally
 - Geographically
 - Specialty Parts & Services
- Create a Larger Footprint Externally
 - Acquisition
 - Partnership / Joint Venture
- **Sell and Stay** for a Second Bite

Consolidation

- Maybe this time participants will **keep and grow** the smart, entrepreneurial ex-owners as key managers.
- Maybe this time participants will use freshly infused capital to combine back offices, systems, inventory, purchasing power and expanded customer contact... **immediately.**
- Maybe this will be the chance for HD distribution to catch up in **providing world-class customer service, while making a fair margin.**

Enjoy the Beach!



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GAS

UNLEADED

LOL $\frac{9}{10}$

PLUS

OMG $\frac{9}{10}$

PREMIUM

WTF $\frac{9}{10}$