

Notes from the Road: NADA & HDAW 2023

The Piper Sandler vehicle aftermarket senior team closed out the month of January by effectively taking up residence in Dallas, Texas for two mainstay vehicle aftermarket conferences – Heavy Duty Aftermarket Week (“HDAW”) and the National Automotive Dealers Association Show (“NADA”). Herein, we share key takeaways, observations and specific trends that executives in both sectors are watching closely.

National Automotive Dealers Association Show

The dealership business model continues to evolve and the pace of change is accelerating

The dealership today looks very different than it did 10 years ago. From the customer experience, to profit mix shifting away from the actual selling of vehicles, to increased complexity of the vehicles, to an aging workforce, successful executives and business owners have shifted priorities and enacted creative strategies to navigate the changing landscape. The next decade has even more significant potential changes on the horizon. Most notably, executives at the conference had the following topics at the forefront of their minds: the potential shift to an agency model and direct selling by automotive OEMs; electrification of the fleet and the impact to the sales and service models; accelerating margin compression and the resulting need for technology, tools and tactics to drive efficiencies; and a dwindling technical workforce and pool of potential new technical employees. Most executives expect the pace of change to accelerate, and we believe that a number of these themes represent attractive investment opportunities with large addressable markets for industry players and institutional capital.

Dealership operators are pivoting to service as a defensible, long-term earnings stream

With the tides shifting toward an agency model, many dealers are investing heavily and shifting strategic focus to orient dealership operations toward service. Today, dealerships account for approximately 30% of automotive service completed in the U.S. From body work (collision repair), to general service, to car wash, dealerships across the country are looking to leverage their real estate footprints, infrastructure and well-trained technician staff to take a larger share of the auto services market, including post-warranty services. We heard executives discuss a number of strategies and tactics in respect to growing the services offering including: more competitive or tiered pricing to capture post-warranty work; sourcing of non-OE parts to support a more competitive pricing; and models for attracting, training and retaining technicians.

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National Automotive Dealers Association Show (Cont'd)

The COVID-era used car market will have a long-lasting ripple effect in the aftermarket

Given the high prices that used car buyers (consumers) paid over the last three years, coupled with largely unchanged depreciation curves, negative equity on vehicles is a customer issue for which dealership leaders are thinking creatively about. Our interpretation of this phenomenon, based on the level of concern from the dealership sector, is that the age of the U.S. vehicle fleet will continue to climb (and potentially accelerate). This represents a positive tailwind for the independent aftermarket writ-large. Parts suppliers, distributors and service providers alike will benefit from a larger amount of older vehicles in the optimal “repair window” over the next 5 to 7 years.

There is a robust ecosystem of technology and tech-enabled service providers innovating in the automotive dealership vertical

As we mentioned above, looming margin compression on future vehicle sales and a potential agency model transition have dealership owners and executives highly-focused on efficiencies. Across functional areas – from sales, to service, to used car trades, to F&I – there are a growing number of players developing technology value propositions around customer (dealership) pain points. In our conversations, we have identified several subsectors that we believe have significant white space for growth and are attractive investable themes for institutional capital.

Despite the significant demand for technology solutions, dealers are complaining about “tool overload”

While technology remains a priority and an attractive means to drive efficiencies in the dealership business model, executives in the space are concerned that their teams are managing too many tools. As such, there is a demand for simplification and perhaps unification of the software and technology employed at the dealership. We see a growing amount of innovation coming in this sector.

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Heavy Duty Aftermarket Week

“Trucking” along: no tangible signs of recession in the heavy-duty aftermarket

Given the necessary nature of on- and off-highway heavy-duty vehicles and consistently high utilization levels of the U.S. fleet, executives in the sector are expecting a strong 2023. With demand highly-correlated to utilization, demand for aftermarket parts and services has remained strong.

The heavy duty aftermarket industry remains fragmented with limited institutional capital invested in the sector

Our view of the industry landscape is a barbell – on the one end, there are several large, global suppliers and, on the other end, there is a highly-fragmented set of players (primarily distributors and maintenance & repair service providers) that operate in a local or regional geography. Moreover, there are only a handful of players backed by institutional capital and, as such, we see an investment opportunity that is well-suited for the current market environment – an attractive M&A/roll-up opportunity in a market that is underpinned by stable, recession resistant demand.

Attractive hybrid business models that cover both service and parts distribution

Many of the local and regional part distributors (that are plentiful in the sector) are also providers of repair and maintenance services. We have found it common for a local, privately-owned distribution hub to also have somewhere between 2 and 10 service bays and a team of techs performing repairs and general maintenance for fleet and owner-operator customers.

The Industry Has Limited Digital Disruption

The industry remains oriented around localized distribution and parts supply, which makes sense given the customer focus on asset utilization and the resulting need to limit repair and maintenance downtime. But, unlike our time at the NADA, we did not observe the same level of digital disruption. Although, we sense that there are material opportunities to better connect the parts supply chain through e-commerce, marketplaces and digital technology.

Dealerships &
Dealer Services

Parts
Suppliers

Distributors, Retailers
& E-Commerce

Vehicle Service
Providers

End of Ownership
and/or End of Life

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 <p>has been acquired by</p>  <p>April 2022</p>	 <p>has been acquired by</p>  <p>January 2022</p>	 <p>has acquired</p>  <p>August 2021</p>	 <p>Initial Public Offering</p> <p>June 2021</p>
 <p>Debt Refinancing</p> <p>June 2021</p>	 <p>Equity Capital Raise</p> <p>May 2021</p>	 <p>has been acquired by</p>  <p>March 2021</p>	 <p>Initial Public Offering</p> <p>March 2021</p>

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