

Exit Preparation/Positioning For ~\$1B Automotive Parts Distributor: Developing Growth Strategy In The Outsourced Service Market

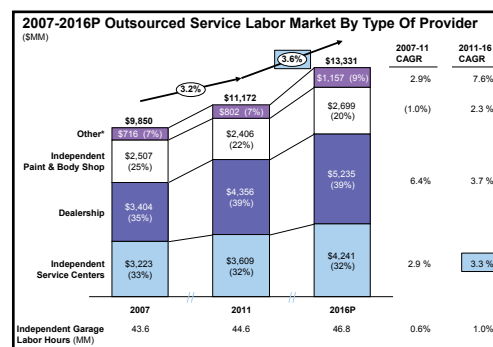
The Challenge: Our client, a ~\$1B distributor of heavy-duty automotive parts, was in the process of being sold and was looking to position the adjacent repair and maintenance services market as its next leg of growth. After creating a national parts distribution network through an aggressive acquisition strategy, our client believed there was a similar opportunity to create a large, multi-location player in the highly-fragmented service market and that it was best-positioned amongst competitors to accomplish this due to its scale and expertise. To validate this, Gotham was asked to conduct a 4-week fact-based assessment of the service market as an expansion/growth opportunity.

Service Business Growth Opportunity Assessment: To build a solid fact base on market and competitive dynamics, Gotham conducted a multi-faceted assessment, including: (1) analysis of industry data and extensive secondary research to pin down the size and growth rates of repair and maintenance services market by segment (service type, vehicle class, vocation, etc.), to establish key market facts, and to understand trends driving the demand for outsourced services; (2) 100+ interviews with independent service center owners to gain a first-hand view of the service business attractiveness, key business risks, and their willingness to be acquired; and (3) detailed competitive analysis across key segments (e.g., independent service center, OEM dealer, tire/lube chains, truck stops with service) and along key dimensions (e.g., price, turnaround time, service offerings). After establishing the attractiveness of the service market, Gotham assessed whether the service business expansion was the right growth strategy for our client by modeling service center economics, establishing synergies between the parts distribution and service businesses, and estimating the size of the potential service center network.

Service Market Large And Growing, Driven By Increasing Engine Complexity

From reconciling available industry data and conducting extensive secondary research, Gotham estimated that the outsourced repair and maintenance services market is large (\$11B) and expected to grow at 3-4% CAGR. We established that several factors were driving this growth:

- Advancements in engine technology from incorporation of electronics and from regulatory changes (e.g., more stringent EPA emission standards) were driving up service requirements and technological complexity, and leading to increased outsourcing
- Increased use of independent owner-operators by trucking companies was leading to increased use of independent service centers vs. in-house service.



Company Well Positioned To Expand Its Service Business In The Highly-Fragmented Service Market

Gotham's detailed assessment of competitive dynamics in the outsourced services market showed that while OEM dealers represent 39% of outsourced services market (driven by warranty work and higher labor rates), independent service centers accounted for 78% of 14,000 service locations, with most of them being small (<5 employees) and family-owned. The only full-service national service networks in this highly-fragmented market are those of OEM dealers – truck (e.g., Daimler, Navistar) and engine manufacturers (e.g., Cummins) – and those of tire/lube chains and truck stops providing basic services (e.g., TA/Petro, Pilot Flying J). Our team conducted a deeper market reconnaissance, including calls to independent service center owners/managers, which showed independents struggling to keep pace with OEM dealers on both skills and resources for newer diagnostic equipment (while OEM dealers spent over \$50K annually on service tools and equipment with half of this spend on diagnostic equipment, independents spent less than \$5K). Gotham concluded that our client was well positioned to take advantage of these market dynamics and build a large service network to compete with OEM dealers for non-warranty work, offering more standard service quality/pricing/billing policies, skilled technicians, and advanced diagnostic equipment than independents.

Service Center Economics And Synergies Are Highly Attractive, With Manageable Integration Risks

To establish the financial attractiveness of the service business, Gotham built a robust financial model of the client's existing network of service centers, benchmarking key metrics (e.g., revenue per technician, parts-to-service ratio, EBITDA contribution), and interviewed company managers to understand the synergies with the client's core distribution business, as well as the criteria and characteristics for top-performing service centers. Gotham supplemented this information with independent service center interview findings to develop a profile (by size, breadth of services, technician qualifications, etc.) of the ideal target service centers. Triangulating the results of several estimation approaches (e.g., MSA-level, market share, highway mileage), we estimated the target number of locations our client's service network could reach and established that there are enough independent service centers available fitting the acquisition criteria to fully achieve growth objectives. We also developed acquisition and integration strategies to mitigate potential risks such as loss of customer-relationship-based sales if previous owner leaves and attraction and retention of qualified, younger mechanics as today's core of longer-tenured mechanics approaches retirement.

The Outcome: Gotham's exit preparation and positioning allowed the company and its investors to paint a clear picture of the source of the next leg of growth – namely the creation of a large, multi-location service network delivering sizable revenue growth over the next 5 years at attractive EBITDA margins. Within weeks of the study completion, the company sold at a rich valuation.