

Automotive Reconditioning

An Industry Ripe for Consolidation

Market Commentary – October 2021

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Automotive reconditioning is the process of preparing a vehicle at a dealership to be retail-ready. All new and used cars go through reconditioning before being put on the dealership lot. Services include wheel repair, exterior repair, paint, paintless dent repair (PDR), interior restoration, and detailing services. Many dealerships outsource reconditioning to optimize operations and decrease inventory turn-times.

The automotive reconditioning industry is \$5.4 billion, fragmented, and ripe for consolidation. Most of the reconditioning outsourcing is to self-employed specialists who serve a single or a few stores. Management of outsourcing to sole proprietors is inefficient for dealerships. There is an unmet need for reconditioning companies with the scale to provide all the necessary reconditioning services coupled with sophisticated management systems that enhance transparency and performance.

In this paper, we cover five primary themes:

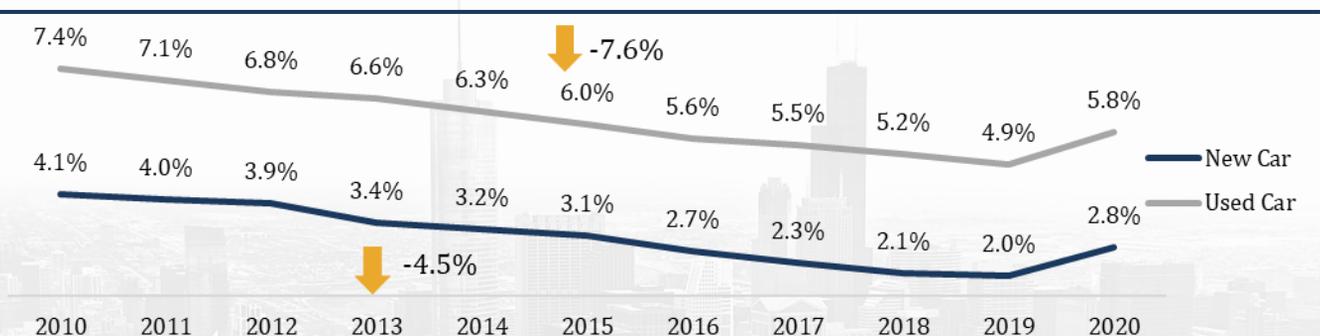
1. Dealerships outsource reconditioning to optimize operations;
2. The automotive reconditioning industry is highly fragmented and lacks companies with scale;
3. More than ever, dealerships need to make vehicles retail-ready as quickly as possible;
4. Dealerships have competing stresses: maximizing profits from fixed operations and turning inventory quickly; and
5. The industry is ripe for consolidation.

Similar to the ongoing consolidation that we have seen in the collision center industry over the past five years, we expect robust M&A activity in the automotive reconditioning industry.

Dealerships outsource reconditioning to optimize operations

Dealerships make only 28.1% of their profit from actually selling cars. Instead, profits are driven by F&I product sales and fixed operations (repair and servicing work). Since 2010, retail new and used vehicle gross margins have steadily declined.

AVERAGE DEALERSHIP GROSS PROFIT MARGIN¹



¹NADA Annual Reports

Dealerships can increase profitability by 1) reducing overhead, 2) freeing up resources to focus on profit centers, such as fixed ops, rather than tasks such as reconditioning, and 3) selling more vehicles at a faster rate. Time is money in the dealership world. Every day a car sits on the lot, it costs a dealership an estimated \$40.

Most dealerships realize the importance of outsourcing, and we estimate that over 80% of dealerships already outsource at least one component of reconditioning. On average, outsourcing reconditioning reduces time-to-retail by an average of five and a half days, and for a 100 vehicle per month dealership, yields an additional profit of \$264,000 annually. The ten largest public dealership groups disclose that they outsource reconditioning to some level. Additionally, Vroom, one of the largest online retailers, outsources a majority of its reconditioning needs.

Automotive reconditioning industry is highly fragmented and lacks companies with scale

The automotive reconditioning industry is immature. Most of the reconditioning outsourcing is to self-employed specialists who serve a single or a few stores. Although outsourcing to individuals relieves the pressure on dealership technicians, managers need to monitor multiple vendors and remain at the mercy of individuals servicing several dealerships. The managers lack transparency into the vehicle reconditioning status. Moving vehicles between technicians increases turn-times. Additionally, these vendors do not have sophisticated systems, making work order processing difficult for managers.

Colonnade estimates that there may be as many as 40,000 reconditioning companies in the U.S. Most of the industry is comprised of sole entrepreneurs that service multiple dealerships with a single skill, such as paint. There are some regional providers, such as Streamline Recon, that service a few metropolitan areas. Dent Wizard is the largest company in the industry. It was acquired by DealerTire, a portfolio company of Bain Capital, in 2020.

Most dealerships have an unmet need for reconditioning companies with the scale to provide all the necessary reconditioning services coupled with sophisticated management systems that enhance transparency and financial management.

More than ever, dealerships need to make vehicles retail-ready as quickly as possible

The automotive industry has insufficient inventory at dealerships to meet strong consumer demand. As a result, the retail sales pace is depressed, and transaction prices are elevated. Consequently, inventory turn-times are critical.

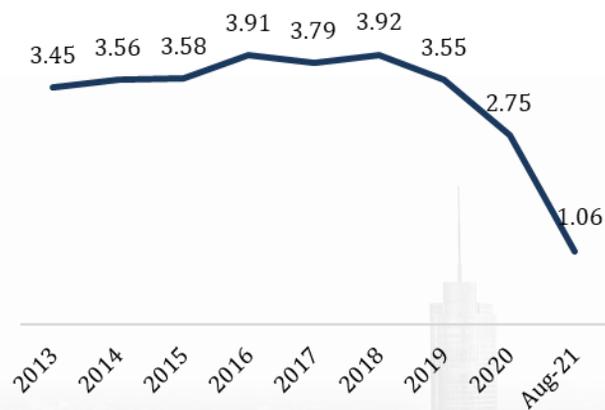
Inventory levels and day's supply are at historic lows

Inventory turn times at dealerships are more critical than ever, as the automotive industry has insufficient inventory at dealerships to meet strong consumer demand.

Disruptions to the global supply chain and the microchip shortage have driven down new inventory at dealerships in the U.S. In addition, the new-vehicle deficiency contributes to the used-vehicle deficit as fewer people trade in their cars because they cannot find the replacement they want or because the new prices are too high. Additionally, the high new vehicle prices drive people to buy used vehicles.

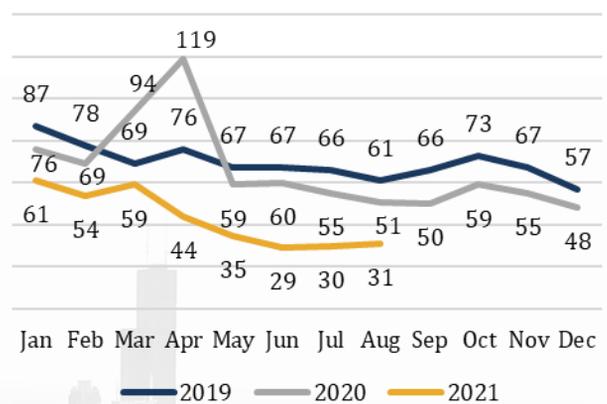
The day's supply of new vehicles reached a record low this past summer. August day's supply was 39% less than 2020 and 49% less than 2019.

DEALERSHIP NEW VEHICLE INVENTORY¹
(in millions)



¹NADA Data 2020 and Cox Automotive

INVENTORY DAY'S SUPPLY²



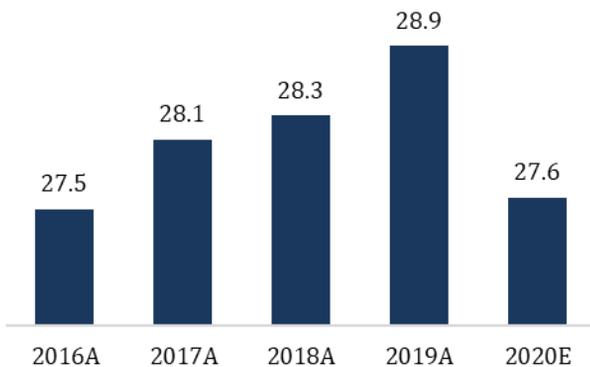
²Wards Intelligence and Cox Automotive

Retail sales pace is depressed

Low inventory at dealerships is depressing sales. In 2020, new and used vehicle sales were hampered by the pandemic. Economic uncertainty and shelter-in-place orders caused new sales to be down 15.2% year-over-year in 2020. However, vehicle sales accelerated towards pre-pandemic levels in Q3 and Q4 2020.

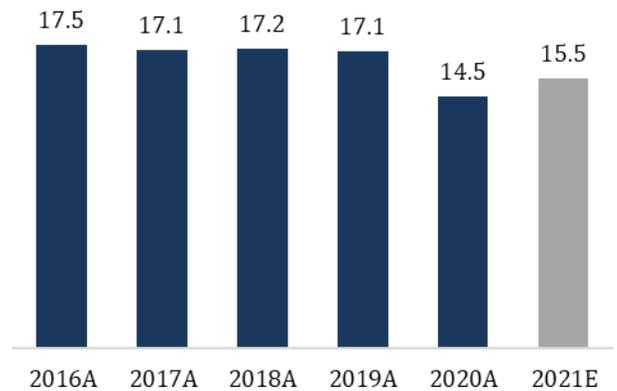
Despite the strong demand, 2021 new vehicle sales are expected at 85% of 2019 sales and equivalent to 2013 sales.

FRANCHISED USED VEHICLE SALES¹ (in millions)



¹2020 NADA Report; 2020E is an estimate based on 38.4 million used vehicles sold including private transactions

NEW VEHICLE SALES² (in millions)

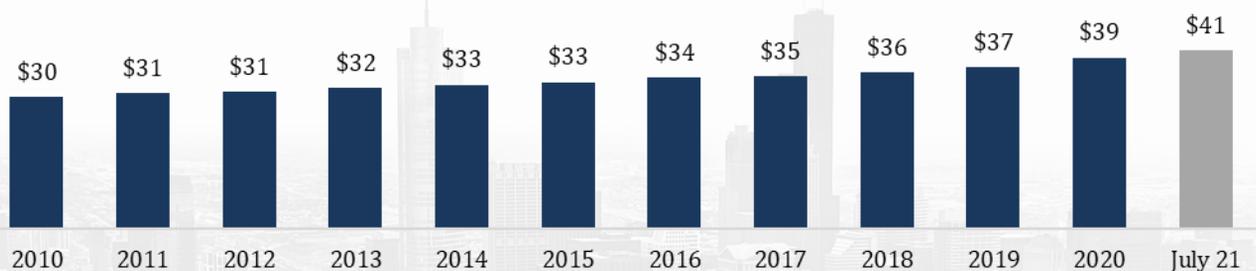


²Cox Automotive 2021 Forecasts as of September 30, 2021

Vehicles prices are at all-time highs

The industry has insufficient new inventory at dealerships to meet strong consumer demand. Consequently, transaction prices are elevated. In August 2021, average new prices reached an all-time high of \$41,378, which was 16% higher than August 2020.

AVERAGE NEW VEHICLE RETAIL PRICE (\$ in thousands)



The lack of new vehicle inventory is steering many dealers and consumers into the used vehicle market, resulting in higher prices for wholesale and retail used vehicles. The average used retail price in August 2021 reached \$25,400, a 21% increase over the same month in 2020.

AVERAGE USED VEHICLE RETAIL PRICE (*\$ in thousands*)

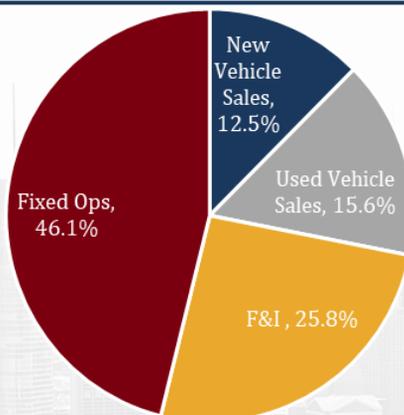


Dealerships have competing stresses: maximizing profits from fixed operations and turning inventory quickly

Fixed ops is a critical component to dealership profitability

Fixed operations (“fixed ops”) include the service lane and the body shop and represent 46.1% of a dealership’s gross profit. In 2020, dealerships sold \$111 billion in fixed ops, averaging \$7.1 million per dealership. Year-over-year fixed ops sales were down 7.9%, largely due to shelter-in-place orders.

AVERAGE DEALERSHIP GROSS PROFIT¹



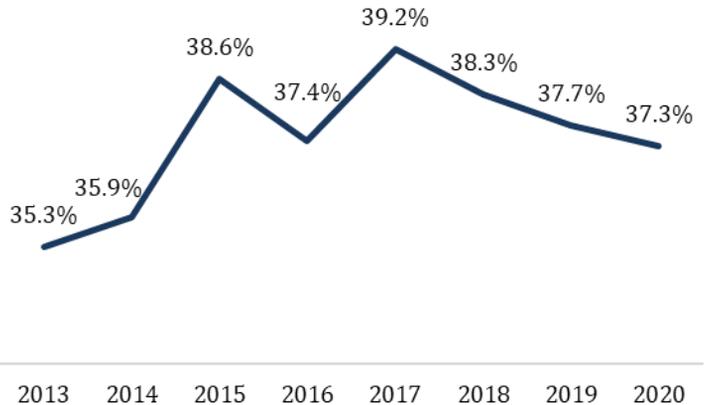
¹ NADA 2020 Average Dealership Profile

Skilled technicians are expensive and in high demand

Allocating fixed ops personnel to reconditioning causes margin compression. Fixed ops technicians are highly skilled and compensated. Reconditioning takes away from time that could be used to sell high-margin services. 59% of fixed ops sales are for parts, and vehicle reconditioning does not involve parts. If a dealership's fixed ops technicians are busy with customer work, they may deprioritize reconditioning, thereby increasing the time for a vehicle to be lot-ready.

In addition, the number of dealerships with on-site body shops is declining. These dealerships outsource dent repair and other body work which extends the time a vehicle is in inventory.

DEALERSHIP OPERATING ON-SITE BODY SHOPS



Source: NADA 2020 Average Dealership Profile

Vehicle time on dealership lots is decreasing

Over the last twelve months, the average time a vehicle spent on a dealership lot was 35.5 days, a 15% decrease compared to the twelve months prior. June and July 2021 recorded the lowest amount of time for vehicles on the lot at an average of only 32 days, caused by high demand and low supply. The average cost to a dealership for a car on the lot is \$40 per day. Therefore, for dealerships, saving time to get a vehicle to market is an immediate saving in their cost per vehicle.

VEHICLE DAYS ON DEALERSHIP LOTS



Source: Black Book September 11, 2021 Report

Automotive reconditioning industry is ripe for consolidation

Like the significant consolidation that we have seen in the collision center industry over the past five years, we expect robust M&A activity in the automotive reconditioning industry.

Case Study: Collision Center Industry

The collision center industry has experienced significant consolidation over the past five years. There are many similarities between the collision center and automotive reconditioning industries, such as being highly fragmented and populated with mom-and-pop shops. Private equity firms have invested in platforms and are now rolling up smaller players. The larger collision center franchises have been acquiring regional and small family-owned collision centers to expand their geographic footprints. In addition, software has helped to transform the collision center industry.

Group	Number of Acquisitions in 2020
Caliber Collision (<i>Hellman & Friedman</i>)	14
Classic Collision (<i>New Mountain Capital</i>)	33
Crash Champions	37
Gerber Collision & Glass (<i>Boyd Group; BGSF</i>)	36
ProCare Collision (<i>Kinderhook Industries</i>)	6

Conclusion

Automotive reconditioning is a large and highly fragmented industry that is ripe for consolidation. Dealerships outsource reconditioning to optimize operations and improve profitability by reducing overhead, focusing on profit centers such as fixed ops, and selling more vehicles faster. Industry trends are driving increased demand for outsourced reconditioning services. Most dealerships have an unmet need for reconditioning companies with the scale to provide all the necessary reconditioning services coupled with sophisticated management systems that enhance transparency and financial controls. Scale and sophistication can be achieved through a consolidation strategy.

Similar to the significant consolidation that we have seen in the collision center industry, we expect robust M&A activity in the automotive reconditioning industry.

Colonnade is a leading advisor to the automotive services industry



Focus. Expertise. Results.

openroad
LENDING

has been acquired by

CLARION
CAPITAL PARTNERS, LLC

The undersigned acted as exclusive financial advisor to OpenRoad Lending

Colonnade Securities LLC

smart autocare

has been acquired by

Tiptree Inc.

Tiptree Inc.

The undersigned acted as exclusive financial advisor to Smart AutoCare

Colonnade Securities LLC

CALTEX

has been acquired by

SPECTRUM
AUTOMOTIVE HOLDINGS

a portfolio company of

CORNELL
CAPITAL

The undersigned acted as exclusive financial advisor to CalTex Protective Coatings

Colonnade Securities LLC

PMC | **PROTECT**
MY CAR

has been acquired by

Crestview

Crestview Partners

The undersigned acted as exclusive financial advisor to Protect My Car

Colonnade Securities LLC

ENDURANCE

has been sold to

TRP Capital Partners

Colonnade acted as exclusive financial advisor to Endurance Warranty Services, LLC and Endurance Dealer Services, LLC

Colonnade Securities LLC

AUTOMOTIVE
Development Group

has been sold to

APCO
AUTOMOBILE PROTECTION CORPORATION

Colonnade acted as exclusive financial advisor to Automotive Development Group LLC and The Zabel Companies

Colonnade Securities LLC

SKYAUTO
PROTECTION

has been acquired by

smart autocare
a subsidiary of

Tiptree Inc.

The undersigned served as exclusive financial advisor to Sky Services LLC

Colonnade Securities LLC

MediaStratX

has been acquired by

MATRIX
WARRANTY SOLUTIONS INC

The undersigned acted as exclusive financial advisor to Matrix Warranty Solutions

Colonnade Securities LLC

D.E. Shaw & Co

has sold

PayLink
to an investment group led by

OXFORD

Colonnade acted as exclusive financial advisor to D.E. Shaw and Paylink Payment Plans

Colonnade Securities LLC

OMNISURE

has been sold to an investment group led by management and

Fortress Investment Group LLC
(NYSE: FIG)

The undersigned acted as exclusive financial advisor to Omnisure Group, Lincoln Park Capital and Management

Colonnade Securities LLC

HARBERT
MANAGEMENT CORPORATION and **NORTHSTAR**
CAPITAL LLC

have sold

PREFERRED WARRANTIES
INC. to **KAR**
AUCTION SERVICES

The undersigned acted as exclusive financial advisor to Harbert Management Corporation, Northstar Capital LLC and management of Preferred Warranties Inc.

Colonnade Securities LLC

INDEPENDENT
FINANCE

has sold

MMEPCO
finance corporation

to

Seabury Asset Management LLC

The undersigned acted as exclusive financial advisor to Mepeco Finance Corporation

Colonnade Securities LLC

CAPITAL Z
PARTNERS

has acquired

Portfolio

Colonnade acted as financial advisor to Capital Z Partners Management, LLC

Colonnade Securities LLC

MMEPCO
insurance premium financing

has been acquired by

Independent Bank Corporation
(NASDAQ: IBCP)

The undersigned acted as exclusive financial advisor to Mepeco Insurance Premium Financing, Inc.

Colonnade Advisors LLC

AutoAssure
Extended Repeat Coverage

has been sold to

ENDURANCE

TRP Capital Partners

The undersigned acted as exclusive financial advisor to AutoAssure, LLC

Colonnade Securities LLC

APC
Integrated Services Group, Inc.

has been acquired by

SOUTHFIELD

and management

Colonnade acted as exclusive financial advisor to APC Integrated Services Group, Inc.

Colonnade Securities LLC

SOUTHFIELD

has acquired with management

VANGUARD
DEALER SERVICES

Colonnade acted as financial advisor to Southfield Capital

Colonnade Securities LLC

tricolor

a portfolio company of

Serent
CAPITAL

has been sold to

Ganas Auto
a portfolio company of Investar Financial

The undersigned acted as exclusive financial advisor to Tricolor Auto

Colonnade Securities LLC

For more information on automotive reconditioning industry, please contact:



Gina Cocking
Managing Director
312.425.8145
gcocking@coladv.com



Jeff Guylay
Managing Director
208.726.0788
jguylay@coladv.com



Colonnade Advisors LLC • 600 Cleveland Street • Suite 272 • Clearwater, FL • 33755
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Sources: NADA, Cox Automotive, Wards Intelligence, Black Book, and Colonnade research

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