Kingsmoor Advisors

WHY SHOULD I SELL MY BUSINESS?

CONGRATULATIONS.

By downloading this whitepaper, you have taken a critical first step in protecting and realizing the value in your business that you and your family have sacrificed to build.

In this paper, I will explain the consolidation of the vehicle physical damage ecosystem and what that means to you. Understand that the stakes for you are high, and that this consolidation will have a profound near-term impact on how you live the rest of your life.

While our discussion will focus on consolidation, it's important to note that other disrupting factors in your industry – such as the collaboration and consolidation within the industry's supply chain, the evolution of the use of technology to analyze and drive down the cost of repair, the increasing complexity of repairs driven by the increasing use of technology and advanced materials in vehicles – will have an equally important impact on shaping the environment in which you compete.

These factors should also be incorporated in your thinking about the future of your business, and there are excellent resources available to help you better understand what they mean for your operating performance, capital requirements, and the value of your business. I would highly recommend CCC's Crash Course series, which can be downloaded from their website.

My goal in this paper is to help you understand what is happening in terms of industry consolidation, and to help you to determine how to respond most effectively in a way that helps you achieve your life goals.

Here's what you need to know.

UNDERSTANDING CONSOLIDATION

As a starting point, it is important to understand what industry consolidation means – and, specifically, what it means to you.

FIRST, ALL INDUSTRIES GO THROUGH SOME FORM OF CONSOLIDATION. While the end point in terms of share of market concentration among the leading players may vary, industries always consolidate because of the resulting benefits of scale, both in terms of maximizing revenues and in decreasing expenses.

SECOND, CONSOLIDATION HAPPENS THROUGH A SERIES OF STAGES THAT ARE CONSISTENT ACROSS ALL INDUSTRIES. These happen in a highly predictable sequence, irrespective of the industry. Depending on the writer, there are different names for these stages, but the activity and sequence are always the same.

THIRD, THE ACTIVITIES, FOCUS, AND STRATEGIES OF THE CONSOLIDATORS ARE CONSISTENT ACROSS INDUSTRIES IN THESE PHASES.

FOURTH, THE SET OF OPTIONS AVAILABLE TO THE NICHE PLAYERS IN A CONSOLIDATING INDUSTRY ARE EQUALLY PREDICTABLE AND CONSISTENT.

I have been a C-suite executive, investor, or advisor to businesses in eight different industries during different phases of their consolidation. I have seen these patterns enacted over and over in the same way and same sequence. While everyone wants to believe that their industry and business is unique, that’s just not the case. We all ignore the lessons of history at our own peril.

THE STAGES OF CONSOLIDATION

Though there are many academic models explaining the consolidation of an industry, the easiest to understand is a simple three-phase model in which consolidation occurs in three sequential steps:

1) FRAGMENTATION

2) ACQUISITION

3) EXPANSION

It is critical that you look at what is happening around you in the context of this model. Each of these stages presents certain opportunities – and, perhaps, limitations – for business owners looking to exit their companies. By knowing the unique dynamics of each stage, you can be better equipped to make the most of your inevitable exit.

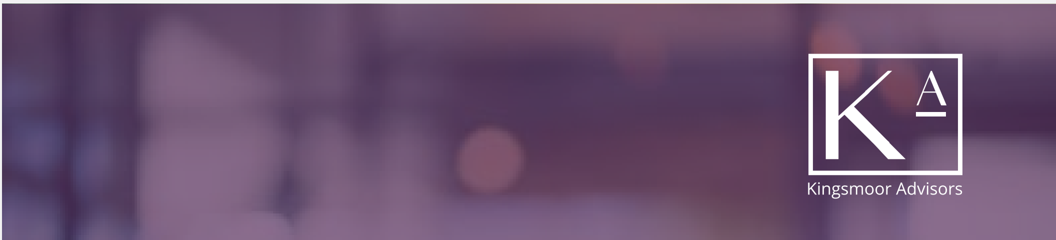
THE FRAGMENTATION STAGE

The fragmentation stage represents the initial development of an industry. Companies focus heavily on growth to build scale and generally focus on an acquisition strategy to acquire volume and build an efficient and profitable business.

THE ACQUISITION STAGE

As an industry moves into this second stage, you'll notice that leaders begin to emerge from the early fragmented stage. These leading companies are attracting capital, allowing them to buy up competitors in a continued path toward acquisitions-based growth. This stage for the collision repair industry has been driven by the aggressive acqusition programs of Caliber, Abra, Gerber, and Service King, and acquisitions have been accelerated by private equity investment in the industry.

The strategy pursued by consolidators in this second phase of industry development is charateized by an increasing focus on acqusitions that add volume and effectively leverage scale. In collision repair, this shift has been marked by an increased focus on in-market acquisition and greenfield/brownfield development which signficiantly improves local and regional market efficiency for the consolidators. New market development is still important, but initital scale in a market becomes much more important than in the fragmentation stage.



The size of the targets in this stage become increasingly important. The market begins to separate into larger and smaller niche players with substantial multiple premiums attached to the former and declining multiples attached to smaller one-off opportunities.

THE EXPANSION STAGE

The third stage in consolidation is expansion. Acquisitions tend to become significantly larger and less frequent as the marginal contribution to a consolidator of a given acquisition declines. The focus on size and contribution to scale increases. The best example of this happening in collision repair was the Caliber/Abra transaction in 2018.

The consolidators are looking to fill existing holes in their product lines or geographic footprints and become significantly more selective in what they buy and what they will pay for what they buy. Premium prices become more unusual and buyers are signficnatly more disciplined on price.

WHEN INDUSTRIES MATURE

When an industry reaches maturity, acquisitions become rare if they occur at all. Share is concentrated in the hands of 2-4 players and they control the destiny of the industry. The key players are focused primarily on leveraging their scale and efficiency rather than on acquisition.

WHERE ARE WE NOW IN THIS PROGRESSION?

"So, Bob," you may be asking, "Why is any of that important to me?"

It's important because your business is at a crossroads. You need to make a decision, and you can only do that if you understand where we are in the consolidation process in collision repair, what that positioning means for the consolidators in the industry in terms of their focus and strategy, and what that means to you – to your business and, most importantly, to the value of your business.

We can't have our Jerry McGuire "Help me help you" moment until you understand exactly where you stand and what is getting ready to happen to you.

HERE'S WHERE WE ARE:

Revenue for North American collision repair industry is estimated to be approximately **US $39.4 billion annually** (U.S. $36.9B, CDA $2.5B).

There are **32,000** shops in the U.S., **4,575** shops in Canada.

Of these shops, **61.2%** were single shops, **28.5%** were large MSO's and **10.3%** were small MSO's and franchises.

The total number of independent and dealership collision repair locations has **declined by 23.1%** from 2008 to 2018, and almost 60% over the past 38 years.

Large multi-shop collision repair operator ("MSO") represented **9.6%** of total locations in 2018 and **28.5%** of estimated 2018 revenue (up from 9.1% in 2006) in the U.S.

99 MSO's had revenues of **$20 million** or greater in 2018.

The top 10 MSO's together represent **68.0% of revenue** of large MSO's.

WHY THIS WILL IMPACT YOUR BUSINESS IN THE NEXT YEAR

I discuss the information above with collision repair shop operators around the country every day. Some operators compete with Caliber or Gerber or Service King on a daily basis, and some compete in markets that are likely near-term targets for consolidation but haven't been impacted by a consolidator yet.

The conversation often goes like this:

> *That's all well and good Bob, but I don't see any of that happening. My business has been around for 3 generations and 50 years and I'm doing just fine.*
>
> **OR**
>
> *These guys have been in my market for years and I kick their asses every day. I'm not scared of these guys at all. They are lousy operators, and no one wants to work for them. What do you say to that?*

What I say is the following: The nature of the competition you face is evolving. In the past 10 years, the primary strategic emphasis of the consolidators you've been facing has been to establish and expand their geographic footprint, oftentimes via marginal acquisitions that have cost them operational efficiency. This isn't unique to collision repair; it's a part of the natural consolidation process.

Now, these players are shifting to more effectively leverage the scale they have acquired.

Not only are they becoming more selective in what they acquire, they are becoming more focused on efficiency in the way they grow.

I believe that we are late in Stage 2 (Acquisition) or early in Stage 3 (Expansion) in terms of consolidation in the industry. What that means is that the consolidators, both national and regional, will continue to focus on acquisition as an important source of growth, but, over the next 18 months, they will become increasingly selective about what they acquire.

Part of the pattern, as consolidation shifts from Stage 2 to Stage 3, is that absolute growth becomes less important than efficient growth. There will be an increasing emphasis on establishing dominance by building out existing markets, either by focusing more on tuck-in acquisitions in an existing market, or by adding greenfield or brownfield development as an increasingly more important growth strategy.

There is already considerable anecdotal evidence of this shift in strategy in Caliber's increased focus on development and market efficiency over acquisition. That change was documented in an interesting presentation by the company's COO on their approach to organizing for markets where they have high or dominant market share (you can view it here).

As the consolidators shift into Stage 3, the change will have a direct effect on both the pricing for your business and on your ability to actually get your business sold. While strong, high-share regional MSOs will continue to be attractive and command premium multiples, overall pricing will trend down significantly. Exit for single shop operators and small MSOs will become progressively more difficult as consolidators use their substantial economy of scale advantages to drive market share. In turn, single shop and small MSOs will suffer. I believe that the value of single shops and small MSOs is going down every day.

WHAT YOU SHOULD DO

What you need to do is get some help to look objectively at your business and market. You need to better understand the options you have available to you to protect the value you and your family have built.

There really are only two theoretical options available to you at this point:

1. ACQUIRE OR MERGE WITH OTHER SMALL PLAYERS IN YOUR MARKET TO TRY TO CREATE ENOUGH SCALE TO PROTECT YOUR BUSINESS.

2. IF YOUR BUSINESS MEETS THE CRITERIA FOR ACQUISITION IN TERMS OF PRODUCTION CAPACITY, LOCATION, AND MARKET CONFIGURATION, CONDUCT A SALE PROCESS THAT WILL MAXIMIZE THE VALUE OF BOTH YOUR OPERATING ASSETS AND YOUR REAL ESTATE.

While it's theoretically feasible to pursue option 1, the reality is that increasing share of market by acquisition or merger is an incredibly difficult proposition for a small independent operator.

The capital requirements are significant and doubling down in a consolidating industry is a very risky proposition. The integration challenges are difficult for experienced acquirors and are even more of a hurdle for those that haven't been through the process before. I really believe that this is only a viable strategy for larger regional MSOs who have the financial and human capital to undertake a challenge of this magnitude.

Your only real choice is to be smart about the timing of a sale. And, in this decision, time is of the essence.

HOW CAN WE HELP?

Kingsmoor has advised buyers and sellers on well over 100 transactions with an aggregate enterprise value of over $6 billion across a broad range of industries. We have significant experience in the collision repair and have successfully guided people just like you through a sale process that has changed their lives.

We can do the same for you.

You can capitalize on the value of your business. But you need to act before the market collapses the value you've built.

Please take a look at the other information we have on our site about our credentials, past successes, and what a sale process would entail, and call us to schedule a consultation.

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