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## Episode 6: New Opportunities in the Automotive Aftermarket

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Joe Sparacino, managing director of automotive aftermarket investment banking at Stifel, shares his perspective on the industry. From mergers and supply chain disruptions to the introduction of new markets focused on Advanced Driver Assistance Systems (ADAS), Joe and Ryan uncover the trends that have investment bankers and key stakeholders taking notice.

**Ryan Mandell:** Welcome back everybody to the Mitchell Collision Podcast. I'm your host, Ryan Mandell, and we're very fortunate today to have a guest with us, Joe Sparacino. He's managing director for automotive aftermarket investment banking at Stifel and someone I've known for several years. Done a ton in the industry. So I think he's got some great insights to share with all of us today. Good morning, Joe. How are you doing?

**Joe Sparacino:** I'm doing well, Ryan. Thank you very much for having me.

**Ryan Mandell:** Thank you so much for sharing some of your time with us and again, your knowledge and insights. Just real quick before we jump into this, why don't you kind of give everyone an idea of your background and some of the things that you've done in the industry and kind of where your focus is these days.

**Joe Sparacino:** Yeah. Happy to do so. As my title implies, I'm a managing director at Stifel leading our automotive aftermarket practice within our Investment Banking Group. Investment banking can mean different

things to different people, but I mainly focus on mergers and acquisitions advisory as well as taking companies public through IPOs or recapitalizing companies through debt, through raising of debt. So very much in the capital raising side of the business and client advisory and, as you've referenced, I've been part of the automotive industry for over 20 years now. That goes back to some operating companies. But I've been really focused on the investment banking side for about 15 years, bringing my team over to Stifel about two years ago. And as you said, I've been fortunate enough to work with a lot of great companies, a lot of different segments of the market, from enthusiasts to tire repair to quick lube to collision to car wash. And then really on the vertical supply chains below all those, you know, as well as in some of the commercial vehicle areas of the market as well.

**Ryan Mandell:** Excellent. So for people who may not be completely familiar with the term automotive aftermarket, can you just give a quick definition of what that entails in terms of the other types of businesses that you would find in the automotive aftermarket.

**Joe Sparacino:** Yeah, it's a great question because I do think automotive aftermarket can mean different things to different people. For me, it's always meant anything that happens to the vehicle that is not its original production. So that can start right at the point of upfitting vehicles around a dealership or dealership services themselves all the way through to salvaging the vehicle at the end of its life cycle. So really anything that happens to that vehicle in between from service, maintenance, car wash or collision repair, really anything like that, as well as the enthusiast side of the market where you have many auto enthusiasts in this country, many more than people understand that live to play with their vehicles of passion, to race it, to personalize it, to take it off roading, to restore an old vehicle. That part of the market is a very big and growing part of the market as well. And, again, something that I think drives a lot of activity in the broader auto aftermarket

**Ryan Mandell:** Collision would fall into the auto aftermarket as well, being that it's something again that takes place with the vehicle that's not part of its original manufacturing process.

**Joe Sparacino:** One hundred percent collision. You know, I tend to segment the market with collision being its own segment. Quick lube, tire, brakes, other maintenance services, kind of another segment. And then, you know, from a services standpoint, I would put car wash kind of in its own segment as well. And then again, all this other enthusiast's more discretionary things that you do to the car. Again, I think of, you know, a different segment also.

**Ryan Mandell:** Great. We hear a lot right now about things that are going on economically in terms of inflation. We see supply chain challenges that are taking place. So how do you see that some of these forces are impacting what companies are doing in the automotive aftermarket?

**Joe Sparacino:** The supply chain disruption is affecting all companies of all sizes throughout all parts of the U.S. GDP. So it's no secret that the aftermarket, in particular, a lot of parts are sourced out of various countries in Asia. And therefore, all these disruptions that have occurred around the pandemic have certainly cascaded through what are now higher prices for just about everything here in the US. The global chip shortage has persisted, which has driven up used car prices—which is one of the key catalysts or leading high inflation segments of the economy. And that's just, again, had a ripple effect down through all segments of market.

**Ryan Mandell:** Talking about collision parts and replacement parts, we're seeing a lot of data that's showing disruption across the spectrum in terms of different parts categories, delivery times are up and it's taking a lot longer to get parts. Is there anything inherently about the way that the aftermarket does business that puts them in a better position to capitalize on some of this disruption that's taking place? Or are they kind of in the same boat as everybody else right now?

**Joe Sparacino:** A little bit of both. I think a lot of the crash parts in the market are sourced out of places like Taiwan, which like China, is also a big market for imports and had seen disruptions in the manufacturing base early on in the pandemic. You know, we've seen freight costs nearly triple over the last two years. We've seen the price or costs of cardboard as an example for just getting parts packages delivered skyrocket. So you add tariffs into that which were implemented in '18 and '19 and you just have very severe rising cost environment just on the input side. So the aftermarket is in an interesting position in that there are some onshoring opportunities. We've seen the push for more domestic or North American supply with a lot of companies as an alternative back up were kind of just secondary source being key initiatives. And we've also seen a lot of growth in re-manufactured and recycled parts in that those parts are here. They are very much a greener alternative and their availability and the rising cost of used vehicles have made them a great alternative in many cases to OEM parts or aftermarket parts.

**Ryan Mandell:** I think that's interesting. You bring up that green alternative type of stream. Is that something where when you're working with clients and different companies that may be investing in this space, how critical or how important to their forward-looking strategy is that kind of environmental stewardship piece? Is that something that these companies are focused a lot on right now?

**Joe Sparacino:** Very much so and a lot in the last two to three years. ESG (environmental, social and governance) topics have been at the forefront of just about every discussion. We seek out policies from various private equity funds during deals to see how it can fit with an ESG theme. We're often positioning our clients in ways that support those themes and that, again, when you look at where the capital comes from, into a private equity firm and then into a private company. It's a very circular. It's coming from pension funds. It's coming from endowments. It's coming from the insurance companies that drive our industry. So all this money sort of related and recycled in different ways. But how that money gets invested is seeing a lot of scrutiny across the public spectrum from an ESG perspective.

**Ryan Mandell:** And speaking of private equity for folks that might have listened or may be a little bit newer to the financial aspect of this industry, talk about kind of the role that private equity plays in investing in the automotive aftermarket. What's kind of the goal of a private equity firm when they go to invest in, say, a collision company or parts company or whoever that may be?

**Joe Sparacino:** Sure. So private equity firms serve a pretty vital role for their investors. They often get termed as an alternative investment. So big insurance companies or endowments or pension funds will allocate a portion of the money they have to invest into this asset class. And what private equity firms are looking to do with that money in many cases is a leveraged buyout, which is probably the most familiar type of transaction that's happening in the collision industry. And leveraged buyouts are great for businesses that have predictability and stability, which the automotive aftermarket has. You can see the trends of increasing number of vehicles on the road, a lot of consistency, at least until the start of the pandemic in miles driven and an aging vehicle parc, which is accelerated through the pandemic because of the new car shortages. So all in all those factors for a long period of time have sustained this industry and made it a nice, stable place to make an investment. And what they look for beyond that are opportunities for growth. And a lot of the growth in collision has come through the benefits of scale, through consolidation, as well as the benefits of improving operations and making investments, which are often difficult for mom-and-pop operators to do on their own. So the land grab that's happened in the MSO side of the space over the last two decades really has been very much around that theme.

**Ryan Mandell:** Yeah, it's really interesting. I think a lot of people, when they think about the automotive industry, they're thinking OEMs first. And a lot of folks that I come across have this view that the collision industry is going to be slowing down over the years. You know, people aren't going to be driving as much and people aren't going to be owning cars. There is going to be shared mobility. I personally kind of see a bit of the opposite. You know, I see more cars on the road, more personal vehicle ownership actually—especially after the

pandemic because of the shift away from office work and more necessity for ownership of vehicles. Do you see something similar to that or maybe somewhere in between? What are your thoughts on the future of mobility?

**Joe Sparacino:** Yeah, I think I'm in your camp on that. I'm very bullish on personal ownership of vehicles. I was reading something this morning that the city of New York saw its registrations go way up during the pandemic as people who otherwise didn't have a need for a vehicle all the sudden wanted that vehicle, wanted the freedom to kind of move on their own without being in public transportation. And I think that's going to be, that's going to sustain for a while. I think we're seeing that the millennial generation has picked up car ownership, just like home ownership. I think there are more barriers around student loans and other things that, you know, I guess are more systemic to everything that needs to be figured out. But I think people want to have a vehicle. It's an extension of their personality. It's a place to store things. It's convenience. It's an affordable convenience. You know, again, it's just very much built into our lives here. So to disentangle that quickly, I think, is especially outside of just deeper urban environments—where maybe an Uber or shared mobility is more of an option for people—I actually see it, you know, sustaining quite into the long term that you'll have vehicle ownership, you'll have people that love it just as much as their parents and grandparents did. And, you know, it's a bright future overall.

**Ryan Mandell:** Yeah, I would agree with that. That's the way I view the collision industry. The collision industry is going to have a fairly sustainable future and supporting all these vehicles, you know, especially as we see miles driven increase already above pre-pandemic levels. And we're seeing collision frequency essentially back to pre-pandemic levels as well. And so when you look at the collision industry, you've seen this massive consolidation over the past 20 years and the rise of these mega-corporations. Do you see that? Do you think that there's going to be additional consolidation within those larger groups? Or do you kind of see a little more competition rising up from some of these smaller MSOs that we've seen developing over the past few years?

**Joe Sparacino:** Yes. I fully agree with you that the collision sector is in a very good place for the foreseeable future. You know, the the bigger threat we talk about all the time is collision-avoidance technologies, which is really just made that vehicle repair more complex and made it more necessary to have more investment in your shop and an ability to diagnose and recalibrate vehicles pre- and post-collision. So I think very much, you know, consolidation will continue and that could mean, you know, future deals that look like the Caliber and ABRA merger, where two of what were the big four that were consolidating everything, getting together. You know, we have seen that second wave. We've seen investments in sort of the second tier based only on size, second tier of collision MSOs like Joe Hudson's or Classic Collision or Crash Champions. And then again, another cohort that has S&P investment. And then on top of that, you see a lot of private owners joining either buying networks or franchise groups. And again, everyone's looking to have a partner, have a way of dealing with this increasing vehicle complexity, have a way of serving the insurance carriers through DRP or self-managed DRP programs. Those require investment. And I do think that portends continued consolidation.

**Ryan Mandell:** And you mentioned the growth of these crash-avoidance systems, this ADAS technology. And I agree we're seeing that in our data that certainly it makes the repair more complex. There's more technical ability that's required to be able to complete repairs in these vehicles. You're essentially getting the diagnostics done on every single car that comes through shop. And we're seeing the growth of the need for calibrations, too. So when I think about ADAS and I think about where that fits in terms of the general scheme of the automotive aftermarket, I see it as a real opportunity for the aftermarket in general, not only from the collision side, but from a supplier side and vendor side servicing those components as well. What's kind of the strategy that companies are taking to address this greater prevalence of ADAS? Are we seeing parts companies develop technology to be able to provide alternatives to the OEM parts? Or how are companies approaching this?

**Joe Sparacino:** So it starts with the industry, right, fighting for the right to repair laws in various states and federal level to make sure that the aftermarket can get access to all the various data that the vehicle is churning

out. I mean, the vehicle has become a big computer generating tons and tons of data. But understanding the codes that are behind it and reading those off the computer and then making sure you can put back the way it should be. We're seeing new business models arise. Right? Repairify is one of the better examples of someone that is trying to provide an aftermarket solution to all this, which involves both OEM and aftermarket fault codes. And they have, you know, competitors doing the same thing. When you get into the parts side of things, it's very much a new competency for companies new to the aftermarket type of approach where, you know, you need software engineers and you need a much deeper technical base to really figure out how to put an aftermarket solution into effect in a safe way as well. I mean, these are not things you can do without a deep amount of expertise. But the point being we are seeing a lot of investment in it. It is creating new business models. And as you said, I think it's an opportunity overall for the industry.

**Ryan Mandell:** I would say so. I think we look at all these different business models and technologies, and I think we're seeing artificial intelligence play a role in a lot of different aspects and roles in the aftermarket and throughout the automotive industry in general. That gosh, I mean, 10 years ago we probably thought we would sound like science fiction. But, I think manufacturers are looking at using AI for their vehicles themselves in terms of how they predict different scenarios for crash avoidance for all of those different safety systems that are involved. Where do you see AI kind of coming into different segments of the industry? I think a lot of times from our end, we see the AI as being a driver for automating estimates. And that's kind of where Mitchell's big focus is and where a lot of our focus is. So what are some other applications for artificial intelligence that maybe aren't as obvious for folks that are in our industry?

**Joe Sparacino:** Yeah. And I'd say Mitchell and the collision industry in general has very much been an early adopter and driver of AI looking at estimates, as you mentioned—that there's a big productivity savings there. There's potentially an accuracy benefit to it as well. But we see AI creeping into a lot of different things, you know, parts matching and ordering systems and identifying kind of from the VIN what part is actually needed. We see it in search engines for one of our e-commerce clients, sort of AI as you're typing in something for a part you're looking for and that AI learns and learns over time how to quickly direct you to the exact part you need or to a kit that may be even better for solving the whole project. So, you know, we see it definitely in those applications. So overall, AI is going to provide better accuracy, better service and ultimately probably reduce a lot of just general operating costs behind the scenes where you can remove the need for human on more rote things.

**Ryan Mandell:** Sure. And I think it allows then, you know, the people that you have working for your organization, it gives them the ability to spend more time adding value to that business instead of doing these rote tasks that are more just mundane.

**Joe Sparacino:** That's exactly right.

**Ryan Mandell:** So thinking about, you know, just kind of where you start wrapping up here. I like to tell people, it's kind of a follow the money type of scenario. Where do you see investment activity heating up? Where is Stifel seeing more of this interest in different segments of the industry right now?

**Joe Sparacino:** Yeah. So less germane for a collision audience, but we've seen a ton of activity in the car wash sector. And where it ties in, I think, is you see a nice recurring revenue model in that most of these the companies that are most attractive have subscription models behind them. You see the increasing vehicle complexity that's out there requires more care and maintenance, more washing. You need to keep those sensors clean if you want them to detect what's around you. So I think there's a greater use case as well. I mean, my vehicle, told me the other day: go get this washed; your sensor is off. So I do see, you know, how it ties to collision in that respect, but that express wash model is definitely taking off. And I think investors also like the fact that it doesn't matter if you have an EV or if you have a combustion engine or if the car drives itself, it's still

going to need to get washed. And you can put it on a conveyor system, have it come out the other side pretty clean. So that's a big area of investment and it speaks to investor concerns around EVs versus ICE and how that's going to play out. What does ADAS mean and how will that play out? Those are consistent questions we get in every deal we do. What that means for collision more broadly, I do see a lot of investor activity continuing in collision. I think those who have figured this industry out understand that until the entire system is set up in a way that all vehicles are speaking to each other and to the infrastructure around them, you're not going to completely avoid crashes. And with more distracted driving, I do think there's going to be more people on the road. Commuter traffic, at least where I live is seems like it's right back to its miserable self in terms of how many cars are on the road and how long it takes to get to work. Because I think people want to have the personal transportation versus public and that's going to be a factor for a while. So I'm bullish on the sector overall. I think consolidation in and around all these various segments will continue. You know, we've seen trades and recycled parts where a few platforms are being established to go out and consolidate salvage yards. We've seen it in the distribution side. We've seen it, you know, parts and chemicals both on the supply and distribution side. And we've obviously all seen it in the MSO side. So I see consolidation continuing. I see people playing these trends for what they are, which is a great long-term story where benefits of scale are meaningful.

**Ryan Mandell:** Yeah, it sounds like a lot of what's happening. You know, you talk about consolidation of some of these more fragmented industries like recycling. That can be really beneficial for the other players in the industry. So if you're relying on those companies that previously were very fragmented and not well organized and now that's starting to modernize and you're seeing that consolidation, I would imagine that's going to lead to better service, better experiences throughout the entire aftermarket and the entire automotive industry.

**Joe Sparacino:** I think you're absolutely correct on that. Any time there's more professionalization built into anything, it makes everything around it better. It forces the competition to upgrade and do better and ultimately results in kind of a better outcome at the end for the end consumer or end user of that vehicle.

**Ryan Mandell:** Absolutely. Well, Joe, I just want to say thank you so much for your time this morning. I really appreciate you sharing your deep well of knowledge with us. I think there's a ton of takeaways here. It's always interesting for me to talk to you and just understand and learn more about what's going on in the industry. So, Joe, thank you very much. I really appreciate you.

**Joe Sparacino:** Same here. It's always great to speak with you, Ryan, and I appreciate you having me on your podcast. I wish you well.

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