TIRES

CURRENT TRENDS

- As U.S. vehicle miles traveled have straight-lined since early 2017, tire unit shipments are projected to increase only 0.8% for 2018 over 2017, indicating a fairly static market
- Rising raw material costs are compressing margins for manufacturers

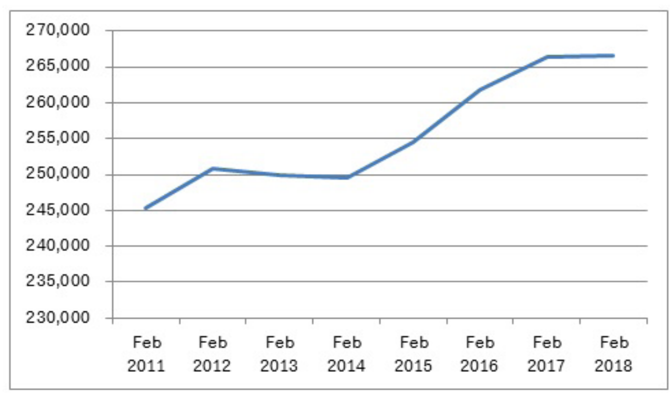
PROJECTED VALUES
(12-MONTH OUTLOOK)

APPROXIMATE NET RECOVERY ON COST (DISTRIBUTORS)

55-70%
passenger tires

55-75%
truck tires

VEHICLE MILES TRAVELED (SEASONALLY ADJUSTED)



Source: Bureau of Transportation Statistics

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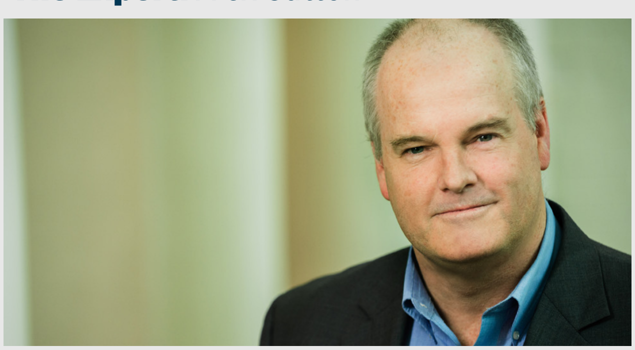
IMPACT OF STEEL TARIFFS PENDING: In March 2018 the Trump administration announced 10 and 25 percent tariffs on imported aluminum and steel, respectively. Subsequently, the United States began continuing discussions with Canada, Mexico, Australia, Argentina, South Korea, Brazil, and the European Union (on behalf of its member countries) as to whether imports from these countries or jurisdictions will be subject to the tariffs under section 232 of the Trade Expansion Act of 1962 (the provision that allows additional tariffs when national security is affected). Further, in May 2018 the White House announced that every country granted an exemption from the tariffs will face an import quota and other restrictions. With the tariffs set to take effect on June 1, 2018, the full impact of the tax on the tire distribution industry is as yet unclear, but the auto industry is likely to feel the impact over time. As the price of aluminum and steel rises, the costs to manufacture cars, trucks, and auto parts will rise with it.

For the tire industry in particular, the price for tire cord-quality wire rods, which are used to reduce a tire's weight, will increase based on where the steel is sourced. In 2017, U.S. imports of tire cord-quality wire rod came from seven countries: Brazil (56 percent), Japan (27), South Korea (8), Spain (4), Germany (2), United Kingdom (2), and Canada (0.03). All countries supplying tire cord-quality wire rod to the United States except Japan were temporarily excluded from the steel tariffs; however, it remains to be seen what the impact will be on import costs after the effective date. To the extent that metal prices increase, manufacturers and distributors will be forced to assume the increases or pass them along to the consumer in order to maintain margins.

HIGHER RAW MATERIAL COSTS HIT MANUFACTURERS: Tires are manufactured from both synthetic and natural rubber. Synthetic rubber is derived from polymers found in crude oil; it takes approximately seven gallons of oil to make one tire. As of late April 28, 2018, oil was $67.98 per barrel, an increase of 30 percent from $52.16 over 2017. The price for natural rubber traded on the Singapore Commodity Exchange dropped to a new low in November 2017, and has risen modestly since then. Although the lower cost of natural rubber has helped tire manufacturers, the higher cost of oil has mitigated this benefit.

Despite showing a slight increase over last year, rising oil prices may negatively impact road travel moving forward. According to the U.S. Department of Transportation's Bureau of Transportation Statistics, total vehicle miles traveled increased by 0.9 percent for the 12 months ended February 2018 over 2017. However, the impact is being felt now by some companies.

The Expert: Alex Sutton



Alex Sutton oversees the production of Gordon Brothers inventory valuations. Prior to this role, Alex headed AccuVal-LiquiTec's Inventory Valuation practice, which was acquired by Gordon Brothers in 2015, where his team produced reports used primarily for financing and financial reporting. Read his full bio [here]

In late April 2018, Goodyear reported a sharp drop in its quarterly profits due to high oil prices, high raw materials cost, and weak demand.

TYPE OF TIRE AND ORIGIN OF MANUFACTURE IMPACT RECOVERIES: Lenders should monitor inventory mix closely. The versatility of all-season tires typically results in stronger recoveries, whereas seasonal tires may face steeper discounts. Similarly, truck tires tend to outperform industrial tires in liquidation. Origin of manufacture may also influence appraised values. Domestic tires tend to recover 5 percent to 10 percent higher on average than foreign tires. This difference is largely attributed to brand recognition as the market views brand power as a proxy for quality. Since imported tires lack such recognition, they are perceived to be of lower quality.

AMAZON PARTNERS WITH SEARS: As Sears continues its fight to return to profitability, the company has recently partnered with Amazon to be the official installer for all tires sold on the website. Over the past few years, Sears has taken actions to right-size the chain, increase liquidity, and capitalize on the value of its brands. Per CNBC, the department store chain's shares surged more than 20 percent in early trading on the news. As Sears already sells items from its Kenmore and DieHard brands on Amazon.com, the launch of this service partnership represents the next step in an ongoing push toward capitalizing on the reach of the e-commerce platform.

GOODYEAR MOVES TO WHOLESALE STRATEGY: In an attempt to reset its business after a difficult period, Goodyear Tire & Rubber announced in April that it will be ending its direct supply relationship with American Tire Distributors Inc. (ATD) as it begins its own U.S.-based wholesaling joint venture with Bridgestone Americas Inc., called TireHub. Goodyear's Q2 2018 profit dropped more than 50 percent due to weaker demand, and management advised that higher raw-materials costs would weigh on the company for the remainder of the year. Reporting from Reuters noted that the majority of Goodyear's raw materials are oil-based derivatives, and crude prices, which have risen nearly 43 percent over the past year, could continue to be a factor in 2018. As a result, the company expects a $50 million increase in raw material costs in 2018, compared with 2017.

The move by Goodyear has prompted ATD to pursue "innovative initiatives," which will be announced at a later date. ATD also asserted that it remains committed to offering the best customer service to its clients and hopes to offset the cost that losing a major brand will bring to its business. In a letter to customers ATD announced that it "will no longer be a Goodyear distributor going forward" but did not specify a timetable for ending the supplier relationship.

Other tire manufacturers are also focusing on their supply chains; Michelin and Sumitomo announced a new joint venture partnership in January 2018, which combines their respective North American distribution operations into NTW, which is expected to be the second largest tire distributor in North America. To the extent that other major tire manufacturers bypass distributors to offset projected increases in the cost of raw materials coupled with lower sales demand, distributors will quickly feel the strain of having to backfill orders sourced from a more limited range of branded manufacturers.

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