

Reflections

August 2021

Carvana, the US online car dealership, has a lofty but straightforward mission to change the way in which people buy cars. Under threat is the uninspiring and lengthy stand-off that customers regularly endure on car dealers' sun-baked forecourts. A study in *The Journal of Industrial Economics* found that up to 80 per cent of customers dislike the car buying process, in stark contrast to the smiles beaming from the inflatable tube people flailing wildly at the roadside. Carvana aims to radically improve the process. Purchase any car, of any vintage, with any features, at a better and fixed price, all in the space of 10 mins. Then have it delivered the next day, or if you want to mark the occasion, picked up at one of Carvana's popular coin-operated car vending machines.

We initiated a holding in Carvana for Long Term Global Growth clients in August 2020; it is still a relative infant in LTGG terms, but our conviction in the stock has continued to grow in this short space of time.

Like many LTGG holdings, Carvana is run by a passionate and visionary founder. For Ernie Garcia III, buying and selling used cars is in his blood. His father founded DriveTime, a used car business with over 100 dealerships around the US. Ernie's time in the family business, led him to the conclusion that buying a car shouldn't have to be a tedious, four-hour-plus experience that leaves most Americans feeling upsold or ripped off... and so the 'The Amazon of Cars' was born.

Carvana poses the question: 'What if instead of the 43,000 used car dealerships in the US, there was just one big one, and it was all online?'. The company aims to address the \$1trn automotive market, currently 20 per cent of the US retail economy. The used-car industry will continue to move online and consolidate the highly fragmented legacy car dealership network.

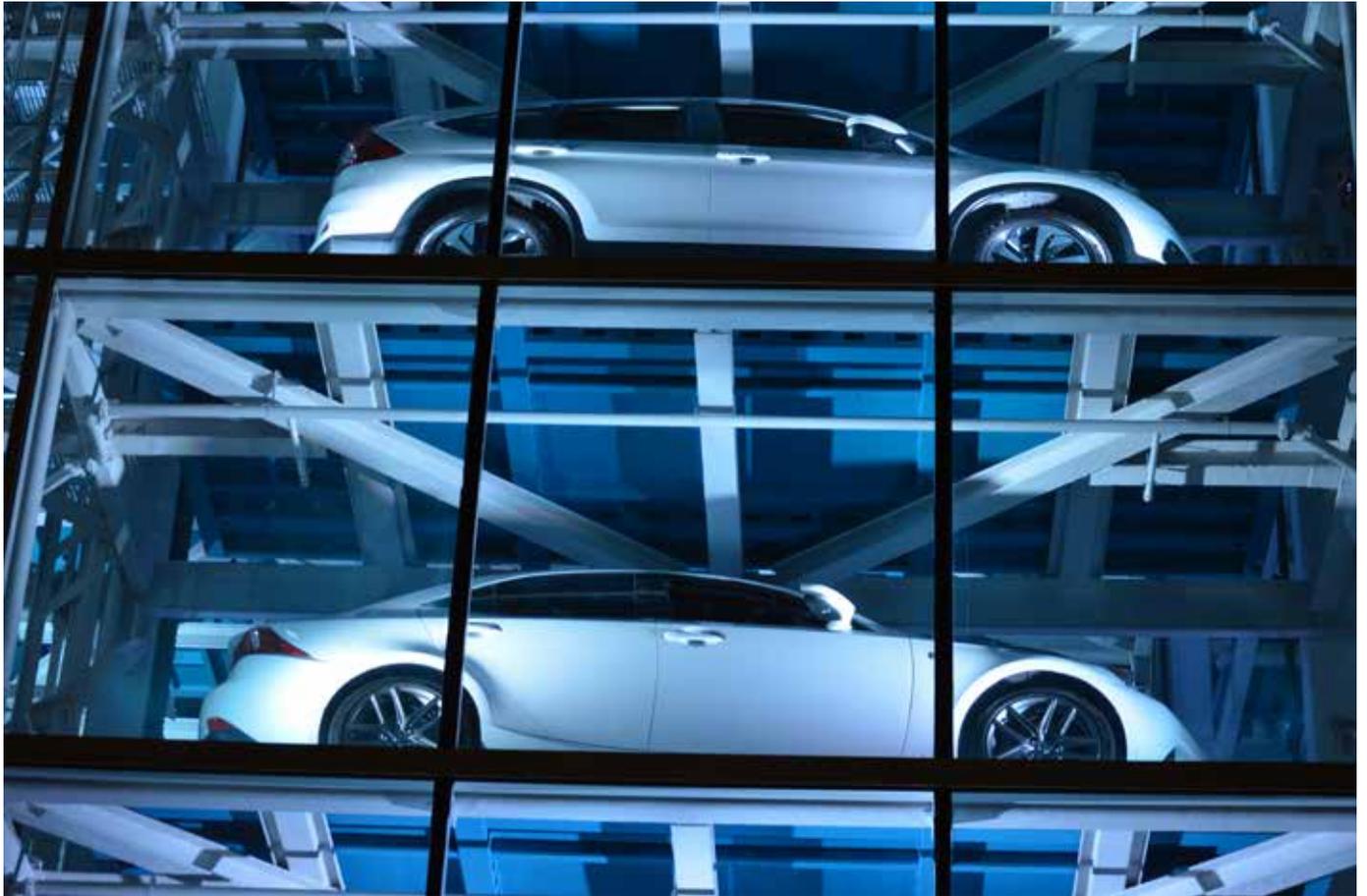
Garcia puts it best himself:

There are all of these different companies and mechanisms that stand between two consumers that are trading cars, whether it's the dealers, the finance companies or the transport companies. So the more of that system that we can collapse, the more we can cut cost out of the system, the more valuable our platform becomes, through a simplified, more transparent offering and the more value we can share with them.



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So how can Carvana achieve this? In contrast to traditional dealerships, success isn't about flashy TV ads or an ambitious sales team working on commission; it's about logistics. The Carvana Logistics Network includes inspection and refurbishment centres, the delivery fleet, and eye-catching vending machines. As this network expands, selection will improve, delivery times will reduce, and car prices will fall. Admittedly, this is costly to scale, but continued execution will make it harder for others to compete. In 2019, Carvana was operating only seven inspection and refurbishment centres, with a total capacity of 350,000 cars per year. The ambition is 21 centres by the end of 2021, with a total capacity of 1.25 million vehicles. Competition is inevitable. Fewer than one per cent of car sales are online, so competitors such as CarMax and Vroom will help accelerate the transition to buying cars online. Carvana is well-placed; its Net Promoter Score sits at an exceptionally high 84.

Despite some logistical constraints due to COVID in 2020, Carvana sold nearly 250,000 cars, generating over \$5bn in revenue, doubling in value since first purchase, so how do we envisage a five-times return from this point? There are roughly 40 million used cars sold each year in the US, and Carvana aims to sell two million of those by 2030. At the current average of \$20,000 per unit, that implies revenues of \$40bn, and with a slight increase in net margins, it is possible to assume a market cap of well over \$250bn.

As we have seen elsewhere in the LTGG portfolio digital disruption continues apace across the US economy, with car dealerships now in the crosshairs. Garcia's customer-centric brand aims to take a growing slice of a vast market opportunity.

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