SMARTER PERSPECTIVE: AUTOMOTIVE

Tire Industry: Smooth Ride or Bumpy Road? Smell of Burning Rubber or New Tariffs?

By Greg Baldor

December 2024 As we approach the end of 2024, the tire industry continues to evolve post-pandemic as opportunities, challenges, and changes within the North American passenger, light truck, and commercial tire market roll on. As the influence of the COVID-19 pandemic (higher labor costs, container shortages, port activity, increased ocean freight costs, rail and trucking disruptions, and extended transit times) on pricing and deliveries subsided, other global events took the front stage. As various container vessels had been removed from service due to lower international commerce, conflicts in Ukraine and the Middle East resulted in longer (and more expensive) routing of raw materials and tires from Asia.

Potential labor strikes in the US and Canada caused many companies to revise supply chain planning, including accelerating inbound shipments. The International Longshoremen's Association, which represents over 47,000 port workers at 36 ports across the United States primarily along the East Coast and the Gulf Coast, contract expired on September 30, 2024. Port workers went on strike on October 1.

Although the strike was suspended on October 3, 2024, with their current contract extended until January 15, 2025, negotiations still continue. On November 12, 2024, the Canadian government invoked federal powers to end work stoppages at the ports of Vancouver, Prince Rupert, and Montreal, ordering binding and final arbitration between labor unions and port ownership. Strike actions by unions and ports ownership lockouts had hit both coasts. In August, the key U.S. northern trade partner had to intervene in a rail workers labor dispute.

Tire manufacturers operate in an intensely competitive international marketplace with diverse needs and specifications that make production more complex and costly. This, in turn, trickles down to distributors, who also now must carry an increasing variety of tire sizes and labels to meet the expanding needs of installers/retailers around the world. These factors, combined with an active merger and acquisition environment, make the tire industry a highly intricate landscape--not just for those along the supply chain, but also for asset-based lenders who must navigate how to support their tire portfolio companies best and limit their own downside risk.

The U.S. Department of Transportation (USDOT) reports that cumulative travel on all roads in 2023 versus 2022 increased by 2.1%, or 67.5 billion vehicle miles, to 3.3 trillion vehicle miles, returning to the 2019 pre-pandemic levels after which consumer driving behaviors changed as many employers allowed office staff to work from home in addition, the first nine months of 2024 versus 2023 recorded a 0.8% increase.

The largest subset of the tire market is replacement tires, or those tires purchased to replace a vehicle's OEM tires due to wear or age. In May 2024, S&P Global Mobility reported that the average age of passenger and light truck vehicles on the road in the U.S. increased to 12.6 years; older tires driven many miles equate to the need for a greater number of replacement tires overall. This ongoing trend, during which we have seen vehicles stay on the road longer, reflects both the increased durability of automobiles and the elevated cost of new vehicles.

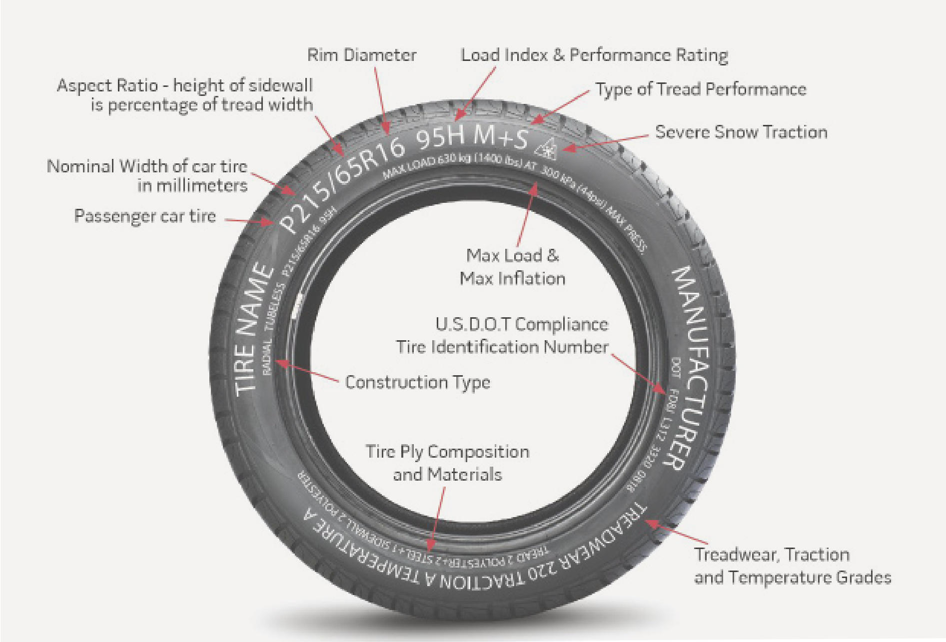
The electronic vehicle (EV) market continues to grow and has unique tire requirements due to an EV's heavier weight and noise reduction requirements, among other factors that differentiate it and its tires from other gas vehicles. Battery-powered EV vehicles, are generally 20-30% heavier than their gas engine counterparts, yet EVs typically create no noise when driven. Additionally, since EVs have strong initial acceleration and high output from the moment a driver steps on the pedal, EV tires must also have stronger traction, steering, and braking performance. In meeting these challenges from heavier weights (stiffer and stronger sidewalls), quieter rides, and improved handling requirements, EV tires are designed with specific stiff and wide center rib patterns, more durable compounds, specialized tread patterns and sound-absorbing foam and rubber compounds.

EV tires are contributing to the growth in tire sizes, which increased by 3 to 393 passenger and 12 to 312 light trucks in 2023 from the prior year. Distributors and retailers literally have the potential options in the 1,000's when brands and private labels, performance characteristics (ultra-high performance, all season, all-weather, winter, etc.), and load & speed ratings are considered.

The U.S. Tire Manufacturers Association (USTMA) is the national trade association for tire manufacturers that produce tires in the U.S. Eleven member companies operate 56 tire-related manufacturing facilities in 16 states. On December 4, 2024, USTMA projected that total U.S. tire shipments would reach 338.9 million units in 2024, compared to 331.9 million units in 2023, and surpass the previous record of 335.2 million units in 2021. Compared with 2023, original equipment (OE) shipments for passenger, light truck, and truck tires were expected to change by -2.6%, 14.6%, and -7.0%, respectively, with a total overall decrease of 0.8% in units. However, replacement passenger, light truck, and truck tire shipments were projected to increase by 1.4%, 5.8%, and 12.5%, respectively, with a total increase of 7.8 million units.

Competition between domestic and foreign tire manufacturers is based on product design, performance, price and

Sizes by Rim Diameter		
Inches	**Passenger**	**Light Truck**
12"	1	-
13"	14	-
14"	26	9
15"	55	42
16"	61	40
17"	65	55
18"	70	53
19"	30	3
20"	40	50
21"	7	-
22"	14	31
23"	2	-
24"	7	21
26"	1	6
28"	-	2
Total 2023	**393**	**312**



Replacement Tire Market Share		
Brand	Passenger	Light Truck
(Based on units:	*215 million*	*34 million)*
Goodyear	**10.0%**	**8.5%**
Michelin	**10.0%**	**6.5%**
Bridgestone	**7.0%**	**6.5%**
Firestone	**7.0%**	**6.5%**
Falken	**5.5%**	**4.0%**
Continental	**5.0%**	**2.0%**
BFGoodrich	**4.0%**	**7.5%**
Hankook	**4.0%**	**4.0%**
Yokohoma	**3.5%**	**5.0%**
Cooper	**3.0%**	**5.0%**
General	**3.0%**	**6.0%**
Kumho	**3.0%**	**3.0%**
Nexen	**2.5%**	**2.0%**
Toyo	**2.5%**	**5.5%**
GT Radial	**2.0%**	**1.5%**
Hercules	**2.0%**	**3.0%**
Pirelli	**2.0%**	**2.0%**
Sailun	**2.0%**	**1.5%**
Kenda	**1.5%**	**2.0%**
Multi-Mile	**1.5%**	**1.5%**
Nitto	**1.5%**	**2.0%**
Sentury	**1.5%**	**<1.0%**
Sumitomo	**1.5%**	**1.0%**
Big O	**1.0%**	**1.0%**
Mastercraft	**1.0%**	**<1.0%**
Maxxis	**1.0%**	**1.5%**
Uniroyal	**1.0%**	**1.5%**
Kelly	**<1.0%**	**1.0%**
Others	**10.5%**	**10.0%**

		2023 Average Advertised Price		
Size	% of Market	Major Brand	Low-Cost Brand	Overall
Passenger				
225/65R17	**5.8%**	**$199**	**$116**	**$177**
205/55R16	**3.9%**	**$164**	**$86**	**$143**
215/55R17	**3.6%**	**$195**	**$104**	**$162**
Light Truck				
LT265/70R17	**8.4%**	**$286**	**$188**	**$262**
LT245/75R16	**8.2%**	**$248**	**$158**	**$224**
LT275/70R18	**7.4%**	**$308**	**$213**	**$297**

terms, marketing programs, reputation, warranty terms, customer service, and consumer convenience. Brands such as Michelin, Bridgestone, and Goodyear enjoy a high recognition factor and have a reputation for performance and and have a reputation for performance and product design. Leading producers offer various house brand tire lines as well as tires manufactured and sold by them to private brand customers, which compete primarily on the basis of value and price.

The USTMA reported the top three estimated replacement tires for both Passenger and Light Truck tires, while the Fitment Group reported average advertised prices in 2023 on these popular tire sizes:

Notable Developments Across the Industry:

<u>Manufacturers</u>
Tires contain rubber compounds and other materials that enable them to perform safely in the face of a wide range of demanding conditions and safety regulations. Materials include natural and synthetic rubber, carbon black, steel cord, fabrics, and petrochemical-based commodities. Substantial quantities of fuel and other petrochemical-based commodities are used in the production of tires, synthetic rubber, and other products.

Tariffs and duties have had a significant effect on the U.S. tire market in recent years. The first Trump Administration's additional 25% Section 301 tariffs on various goods from China, including tires, rubber, and rubber chemicals, took effect in May 2019. Various suppliers shifted production to other countries such as South Korea, Taiwan, Thailand, and Vietnam. Subsequently, the U.S. Department of Commerce announced evidence that tiremakers and tire exporters, including Vietnam, benefited from government subsidies. As a result, a number of consumer tires imported to the U.S. from Asia were assessed with Countervailing Duties (CVD). Other passenger and light truck tire importers would be assessed anti-dumping duties for selling below market cost.

Mexico has jumped to a Top 5 tire-producing country as many tire manufacturers have added plant capacity. In 2023, the US imported over $2 billion or 22.8 million passenger tires and 1.79 million light truck tires from its southern neighbor. During the first half of 2024, three companies, Japanese-based Yokohama Rubber Co. Ltd., China-based Sailu Group, and ZC Rubber Group, announced investments in excess of $1 billion which would lead to production capacities in excess of 24 million passenger and light truck tires.

In June 2021, The Goodyear Tire & Rubber Company (Goodyear) completed the acquisition of Cooper Tire & Rubber Company ("Cooper Tire"), a US-based manufacturer of replacement tires. In its third quarter public SEC filing for the nine months ended September 30, 2024, and 2023, Goodyear noted its Americas unit sales in the first nine months of 2024 decreased by 4.6 million units, or 7.2%s. Replacement tire volume decreased by 5.2 million units, or 9.8%, primarily in our consumer business, driven by increased competitiveness in the U.S. from the lower tier market and the transitory impact from distribution changes in Latin America. OE tire volume increased 0.6 million units, or 5.2%, primarily in their consumer business in Brazil, and the U.S. Net sales decreased by $783 million, or 8.8%, primarily due to lower tire volume of $697 million, unfavorable price and product mix of $233 million.

Distributors

Similarly, various wholesalers/distributors across the industry work to address the ongoing challenges associated with competition and profitability. Among those most notable have been:

TireHub: formed in 2018 as a premium brand-focused distributor and joint venture between Goodyear and Bridgestone – the number 2 and 3 tire producers, respectively, behind Michelin. Established just ahead of the pandemic to more effectively control and ensure continued distribution of their tires in the U.S., the move resulted in the pair removing their brands from the largest U.S. distributor, American Tire Distributors, Inc. (ATD). TireHub has added or relocated TireHub Logistics Centers (TLCs), bringing the total network to 80 TLCs and opening two regional DCs in Pennsylvania and Texas. CEO Ted Becker recently noted, "The wholesale tire distribution channel continues to face pressure in the second half of 2024. Among other things, shifts in consumer demand, consolidation, e-commerce growth, and supply chain changes/disruptions are impacting distributors and the way they do business. That said, we are bullish on the role wholesale distribution plays to

support just-in-time needs for tire dealers and retailers."

ATD, as a result of the loss of the above brands, filed for bankruptcy in 2018. Then again, on October 22, 2024. ATD, reportedly the largest tire distributor in the U.S. with annual sales of $5.7 billion in 2023, says it will continue to operate its network of 115-plus distribution centers that serve 80,000 customers across the U.S. The company says it will continue to support its manufacturer suppliers and provide tires, wheels and other tools to its customers. ATD listed the 30 creditors with the largest claims ($612.7 million) against ATD, and not surprisingly, that list includes the largest tiremakers in the world and in the U.S. market. Goodyear reported approximately $135 million in accounts receivable currently outstanding from ATD. As is customary in some Chapter 11 cases, the court entered an interim order authorizing, but not directing, ATD to pay pre-petition claims of certain critical vendors. Goodyear reached an agreement with ATD regarding the payment of substantially all of our pre-petition claims with ATD. On December 2, 2024, ATD says it had entered an asset purchase agreement with "a buyer entity" subject to higher and otherwise better offers, court and regulatory approval and other closing conditions. Additionally, ATD reportedly expects to operate normally throughout the sale process, which it intends to complete in early-2025.

Montreal, Quebec-based Groupe Touchette, one of the largest independent tire wholesalers in Canada, acquired National Tire Distributors, the former Canadian subsidiary of ATD in September 2022. Currently, the company employs over 1,800 people and has a presence across Canada with more than 50 distribution centers.

Retailers

The above chart from the October 25, 2024, issue of Tire Business indicates the top 12 retailers in the US and Canada as well as their state or providence headquarters.

On the retail side, the big continue to get bigger. In 2023, Mavis Tire Express Services Corp. acquired 595 NTB Tire and Service Centers and Tire Kingdom Service Centers from TBC Corp. Mavis now has more than 1,859 retail stores under 14 brands, including 392 NTB stores and 203 Tire Kingdom locations in 26 states throughout the Midwest, South and Mid-Atlantic region.

Monro, Inc. in its six months ended September 28, 2024, SEC filing dated October 30, 2024, sales decreased 6.4

percent due to lower overall comparable store sales resulting from lower store traffic. Broad-based economic pressures impacting consumers partly led to lower demand for tires, noting the US economy has experienced higher inflation during fiscal 2024 and into fiscal 2025, and there are market expectations that consumer prices may remain at elevated levels for a sustained period. In addition, labor availability has continued to be constrained, and market labor costs have continued to increase. These conditions may give rise to an economic slowdown and perhaps a recession and could further increase our costs and/or impact our revenues. It is unclear whether the current economic conditions and government responses to these conditions, including inflation, changing interest rates, and geopolitical uncertainty, will result in an economic slowdown or recession in the United States. If that occurs, demand for our products and services may further decline, possibly significantly, which may significantly and adversely impact our business, results of operations, and financial position.

The Reinalt-Thomas Corporation DBA Discount Tire Company (DTC), known as America's Tire in Oregon and parts of Washington and California, operates 1,206 stores in 38 states. DTC's parent company acquired the operations of Tire Rack in 2021; Discount Tire Direct previously served as an online tires and wheels purchasing channel for customers outside the trade areas of Discount Tire's retail stores. However, as of April 12, 2024, DTC announced all Discount Tire Direct customers were notified that Tire Rack would service their future needs and a web redirect from Discount Tire Direct to TireRack.com. DTC tire customers who live near a Discount Tire or America's Tire retail location can continue to make tire and wheel purchases online at discounttire.com and have their products shipped to one of the company's retail stores. Those customers who are interested in having their tires or wheels shipped directly to them or – particularly if outside the store footprint of the company – an installer of their choice can shop and purchase through Tire Rack.

<u>Conclusions:</u>

The continued presence of existing and potential tariffs, persisting shipping challenges, and soft consumer confidence all have a significant effect on the North American tire market. In addition to changing duties, high inflation rates may dampen consumers' appetite for driving and possibly delay vehicle maintenance including replacement tires.

Given the current environment, we urge lenders with exposure to the tire industry, and in particular distributor exposure, to closely monitor inventory levels, product mix, and aging. With the number of tire sizes and the number of brands continuing to grow, the need to maintain extensive stock has increased, and we have seen instances of distributors with disproportionate inventories of less desirable, aged merchandise--the best-selling tires may already have been sold. Importing costs continue to shift, and certain companies have inflated inbound freight and duty costs in their perpetual costing, potentially to the detriment of asset-based lenders. Changing market conditions may bring on the use of PSMI or purchase security money interest vendor lien filings that may place a vendor ahead of a lender. In addition to ensuring that borrowing bases are adjusted accordingly for such occurrences, lenders should also be mindful of the impact of threatened tariff increases by the newly voted-in Trump administration.

<u>Hilco Valuation Services</u>

Hilco has significant, validated expertise in the tire marketplace, including production, importation, distribution, and retail installation. Leveraging our deep industry knowledge, we have delivered valuations on dozens of Companies in the U.S. and Canada over the past ten years. As one of the world's largest and most diversified business asset appraisers and valuation advisors, we serve as a trusted resource to companies, lenders, and professional service advisors, providing value opinions across virtually every asset category. Hilco Valuation Services has the ability to affirm asset values via proprietary market data and direct worldwide asset disposition and acquisition experiences. Access to this real-time information, in contrast with the aged data relied upon by others, ensures clients of more reliable valuations, which is crucial when financial and strategic decisions are being made.

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