

PUBLIC NOTE

The Car Wash Bubble

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How can we tell when a boom is tipping into a bubble, and it's time to get out of the way? Even when it seems obvious at a high level...

By our estimates, there are roughly 25 to 30 PE firms of various size in the category today — all trying to establish their foothold, and [grow] a platform they've acquired...

...it can be tricky to drill down to what's really going wrong.

The quote above is from industry leader **Mister Car Wash (MCW)**, which is still controlled by their own sponsor Leonard Green. And to keep things simple, I'll just keep quoting MCW throughout this post. But note that this not an opinion on their stock in either direction, and it will become clear by the end that they are not the most extreme example of the industry dynamics I'm concerned about.

CLEARING THE BRUSH

I'll start with a few secondary talking points that I don't take very seriously:

Car washing is a **feel-good affordable luxury** that has proven resilient during economic downturns...

This is similar to the “cheap date” argument for movie theaters or bowling alleys, and you can find a version of it in almost any consumer discretionary business that can point to a not-so-bad comp trend during the GFC.

If you take a closer look at that GFC data, you will almost always find survivorship bias and other flaws that render it more or less meaningless. And even if you accept the premise that the whole business has been “recession-resistant” in the past, you’ll generally find that it’s not very comparable today.

Movie theaters, for example, have been raising ticket prices much faster than inflation for the past fifteen years, and faster than any honestly-weighted basket of alternatives. They’ve also been steadily losing attendance for that whole time, which makes the current customer base even less comparable.

But we don’t have room here for everything wrong with the movie theater bull case, and I’ll link to a prior post about theaters at the end. Car washes don’t seem to have quite the same ticket-over-traffic problems, but they’ve also had more supply growth, and a *much* faster shift to a subscription revenue model — with MCW at ~70% subscriptions today, vs. ~15% in 2009.

We’ll come back to that subscription model, and how it might make them more or less sensitive to a consumer pullback today. The point for now is just that prior recessions aren’t relevant.

Demand for new locations on the rise as **customer preferences shift towards “do-it-for-me” services...**

This DIY-to-DIFM shift is another common cross-sector theme, and one that’s often more credible — but the cross-sector part is even shakier, and it’s even more important to look at it one business at a time. For example, if auto *maintenance* is becoming less DIY, that’s largely a function of increasing complexity under the hood, and it doesn’t read across to car washes.

And when anyone is gesturing at more of a vague population-level DIY-to-DIFM trend, with customers putting more value on their time or convenience... there’s a good chance that it’s just serving as a proxy for age, wealth, or some other demographic shift in their customer base that they don’t want to point to directly. Or it’s often a supply-side effect, where customers are being pushed into more high-touch solutions whether they’ve asked for it or not, and whether or not the long-term economics make sense for the seller. This second point is precisely what we’re concerned about with car washes, so the DIY-to-DIFM talking point is just begging the question.

Increasing awareness of the relative environmental benefits of professional car washing in combination with municipal water usage restrictions on at-home washing

Let’s file this one under “don’t get high on your own greenwashing.” As I put it in another post about “luring” employees back to the office with new construction:

Can you get Gen Z employees to indicate on a survey that “sustainability” is one of the “core values” that drives how they feel about their workplace? I’m sure you can. But does that mean they will actually show up at the office more often because you’re in a more energy-efficient building?

It's hard to tell whether anyone literally believes that kind of thing. You might say that energy efficiency is a useful goal on its own, and it's harmless to exaggerate the other benefits. But if you start taking this kind of logic too seriously, there will be almost nothing anyone can't sell you.

With car washes, I'd say there's a *slightly* stronger case for a real effect on consumer behavior — but the bar to demonstrate that kind of effect is very high. Even the natural experiment of these municipal regulations would likely be confounded by other variables; I think you'd have to do a real controlled messaging experiment, the way chain restaurants test specials and new menu items across markets. Car washes are not the same kind of business in terms of frequency or marketing spend, and I doubt that even MCW has that kind of scale.

To their credit, MCW is not pushing these points very hard — particularly the GFC comparison, which they often qualify as not very comparable. But at the sector level, if there's a more substantive version of any of these arguments, I'm open to hearing it. I haven't heard it yet. Here's what I've heard instead...

RED FLAG #1: HANDWAVING AROUND SUPPLY GROWTH

Back to MCW, from an investment conference in March:

Q: Do you think the US market is fully penetrated with car washes today?

A: I don't think anyone really knows. There's a lack of good quality data out there. But we can clearly look at the US car park and say it's massive, right? 280-some-odd million vehicles in the US.

There are estimates around the number of conveyors in the United States. On the low end, 10,000, perhaps on the high end, 15,000. Somewhere in between probably lies the truth...

Hmm. In April 2022, they estimated ~10,000. Their trade group says 17,500. And here's the real kicker:

...but in talking to other industry leaders within our space, I think everyone firmly believes [that] the industry could double in size before there's any slowdown or maturation.

To be fair, this is a local business, and even MCW is not in every market. And at the market level, some of the industry commentary gets a little more serious. But for the range to be this wide at a national level — and remember, this is just conveyors, not every older in-bay or self-serve car wash — for the ranges to be that wide is pretty scary.

Even within conveyors, we might be more interested in capacity than the number of locations. And that's another uncomfortable echo of movie theaters — where you may hear about capacity in terms of theater counts, screen counts, or seat counts, depending on the point that someone's making, and there is rarely much effort to reconcile them.

RED FLAG #2: BUBBLE LOGIC AROUND SUBSCRIPTIONS

You've probably seen other commentary about "subscription fatigue" or a "subscription bubble" — but of course it's not a single phenomenon, or even an entirely new one. Not every subscription business is a bubble, and the ones that *are* a bubble have certainly not all burst yet. When it comes to high profile meltdowns like **Stitch Fix** or **Peloton**, each down ~95% from their Covid highs — well, I've written a lot about those too, and they had plenty of other problems beyond subscription math.

But the core mistake that *does* generalize is to over-extrapolate from your current subscriber base to the rest of your target market. The reality of a subscription model is more like depleting a mine — there's some portion of your target customers with a higher propensity to subscribe, and you're naturally going to get them first. All else being equal, they will also be easier to upgrade and easier to retain. So as you move on to the rest, you should expect rising customer acquisition costs and falling customer lifetime values, until they eventually converge and you're in a mature/steady-state market again.

I think the VC world caught on to this problem years ago, and has been demanding more detailed customer cohort data in order to measure it. But the public markets have been slower to demand this cohort-level disclosure in pseudo-tech stories like PTON, and even slower in legacy businesses that have imported the same thinking for their own subscription/loyalty strategies. In many cases, we're still only getting the *aggregate* subscriber KPIs in cherry-picked soundbites, and the sell side is struggling to pry even the most basic breakdowns out of management, like separating "net churn" into cancellations and new customer adds.

At that level of detail, it would be absurd for investors to rely on churn as our primary warning sign. By the time the problem shows up there, it will be far too late to react. Instead, we should be focused on the top of the funnel — and in the case of car washes, the new subscribers generally start out as one-off retail customers, which is still 30% of MCW's business.

So our first alarm bell would be retail underperforming, and that alarm bell has been ringing for a while now. Here is MCW last May:

In the first quarter, we saw really strong performance on both the retail and Unlimited Wash Club subscription side of the business. **Thus far in the second quarter, we're seeing relative outperformance of the UWC subscription side compared to the retail side...**

Q: So if retail is not as strong as subscription, is that some reflection of the current macro uncertainty?

A: So that retail side is going to perform similar to what you would see in a typical retail business. That customer is a lot more sensitive.

So much for “recession resistant,” right? And again, that’s not the current second quarter, that’s a year ago. Here’s the call last month:

Internally, we say thank God for UWC, and thank God our UWC member base has remained so loyal and sticky. Because I can only imagine, had we not had this program in place...

So to the extent there are consumers out there who *would* splurge on a car wash even as they cut back on other spending, these are almost certainly the same customers who have already been pushed into a subscription.

And on *some* level, the operators clearly know this, which is why we’re seeing this “land grab” dynamic and rush to capture share in any given market. In that race to capture the highest-value customers and convert them to subscribers, most other operators are far behind MCW.

But even for those who are winning that game, it can lead to a false sense of security. Because in an oversupply scenario, the incentives to *poach* subscribers from other operators will go up even more. And while location and scale are important, car washes don’t have anything like the same network effects and winner-take-all dynamics as other “platform” land grabs like taxis or food delivery.

DIFFERENT TYPES OF EXPOSURE

I did not find my way to this subject via MCW or private equity, but rather from the net lease investors who have provided much of their funding. More specifically, I’m thinking of the public net lease REITs – who are even more exposed to the long term outcomes than their private peers. Given their permanent equity structure, fluctuating stock prices, and various REIT rules that make it difficult for them to play hardball with delinquent tenants, they’ve historically had a *very* long tail of pain from serious tenant issues. So if we do see a car wash slump, and others in the capital stack are writing down their investments and deploying the next fund, the REITs’ problems may just be getting started.

Given all that, you might expect them to be more conservative than the average sale/leaseback provider, and more focused on land value and other residual/recovery scenarios. But they’re still competing for the same business, and even their caution is often expressed in the same standard credit vocabulary: coverage trends, operator quality, required spreads...

I’m obviously not dismissing these fundamental underwriting standards as “bubble logic.” But when things get a little bubbly on the equity side, we’ve all seen how they can become absorbed into that feedback loop, and lead to even more severe outcomes when the party ends. So even if it’s still rational for some of those 25-30 PE firms to be buying and building car washes, I’d say it’s well past time for the REITs to be pulling back.

References:

MCW quotes are from the 2021 [IPO filing](#), 2022 [slide deck](#), and Bloomberg transcripts. I also referenced two of my own prior articles in the first section:

- [The Future \(and Past\) of Movie Theaters](#)
- [Office Space: A Brief Dose of Reality](#)

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