Memo to: MCJ Capital Partners

From: M. Carter Johnson

Re: Lessons From Greats - Willis Johnson of Copart

Date: 9/20/2021

"I also think a good portion of it has to do with the fact that it never occurred to me that what I was doing might not work. I never thought I couldn't do it." *– Willis Johnson*

In 1972 Willis Johnson bought a five acre auto dismantling yard in Rancho Cordova, California for $75,000. The deal required $15,000 down with interest only payments and the remainder due in five years. At the time, Willis Johnson only had $5,000 to his name. To make the deal work, he borrowed $5,000 from family and friends, and sold his home for the remaining $5,000, opting to move his family into a trailer on the new scrapyard he acquired. It was a bold move, and the first of many that formed the company known today as Copart.

I'm a fan of business stories...Not necessarily the "zero to IPO overnight" type, but more tales of the early grind when the business model itself was taking shape. It's usually these stories where you find the good lessons. When you dig into these lessons, you begin to spot the patterns that ultimately over time weave the framework for success. What makes these patterns so interesting to study is that they often show up in other businesses and industries. Reading about Willis Johnson's story in *Junk to Gold*, clear patterns began to emerge of similar "moves" Johnson utilized during his journey. In this memo we explore five patterns that Johnson leveraged to build Copart into what it is today.

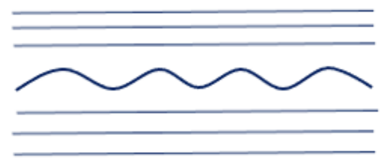
I. Specializing

Early in his career, Willis Johnson learned the power of specializing. For many young operators specializing is counterintuitive. To specialize, one must forgo the opportunity to sell to all (broad market) in exchange for being the preferred provider to just a few (niche market).

Johnson's first use of specialization came when he transitioned one of his early dismantling yards to tailor specifically to the Chrysler brands (made up of Chrysler, Dodge and Plymouth). If you needed a Chrysler, Dodge or Plymouth part, you knew immediately where to go. It also allowed Johnson to buy Chrysler specific inventory from other dismantlers, giving him an inventory sourcing advantage. Ultimately specializing for Johnson was an early win in his career. To understand just how successful this move was, prior to specializing Johnson's dismantling yard was turning over $3,500 to $5,000 worth of parts a month. After specializing, the same yard was doing $3,500 a day.

Seeing the benefits of specializing his yard to a specific brand, Johnson found another opportunity to specialize during the 70's oil crises. High gas prices ignited demand for fuel efficient vehicles such as the Datsun, Chevy Luv and Ford Courier pickups. Johnson realized no dismantling yards had specialized in these vehicles and decided to start "Mather Mini-Truck" in West Sacramento, California. Running the same playbook as his Chrysler yard, Johnson ramped up inventory by telling other dismantlers he was specializing and would gladly acquire any idle inventory they were unable move. The magic of specializing worked again and in no time Johnson had a blue ocean of customers in need of specific mini truck parts.

Specializing for Johnson didn't stop with the Chrysler or mini truck yards. Early in his career at a trade show, Johnson stumbled across a new model called "Pick-A-Part" that he soon put into action himself under the brand "U-Pull-It." The model was simple. For $0.50 at the gate patrons could rummage through the entire yard in quest to find whatever part they needed. Pricing of parts was based on the part in kind and not on the condition. This incentivized customers to hunt for the best part as they paid the same regardless the working state. To keep a level of high inventory, Johnson ran ads in the local paper offering to buy end of life junk cars. This type of dismantling yard gave Johnson three streams of revenue; gate fees, part sales and scrap iron. The success of the model allowed Johnson to specialize at low end price points, appealing to customers who needed to get their cars up and running as cheaply as possible, as oppose to his other yards that catered to mechanics and body shops that needed a certain level of guarantee around purchased parts.



Pattern: Specializing

II. Observe and Replicate What's Working

Specializing was certainly a pattern of Willis Johnson's early success. However, what started him in that direction altogether was his knack for observing and replicating what was working. In fact, the idea of "specializing" was a byproduct of observing and replicating what was working for another entrepreneur. At the time Johnson had taken a trip to Los Angeles to visit Marv Schmidt where he learned about Schmidt's dismantling yard that dealt only with Chevrolets. Johnson found the idea of specializing his yard on a single brand intriguing. Before pulling the trigger on his own Chrysler yard, Johnson went to work heavily researching Al Parker Rambler Parts, and Don Fitz of Fitz Auto Wreckers who both operated several specialty yards. Seeing that specializing was working for them gave Johnson the conviction to replicate the tactic in his own dismantling yard. Johnson was developing a knack of observing and replicating what was working for others.

The act of specializing ironically opened up more avenues for Johnson to observe and replicate what worked on the operational side of the dismantling business. After deciding to specialize, Johnson reached out to other dismantling yards and offered to buy any idle Chrysler (and eventually mini truck) parts. Overnight, this positioned Johnson as a customer and ally as oppose to another direct dismantling yard competitor. As an ally, Johnson was often welcomed to tour their dismantling yards and hear about what was working best. It was here that Johnson would stumble across best operational practices that he would take back and implement in his own dismantling yards. Again, Johnson observed what was working for others and replicated in his own business.

Yet Johnson was not dependent on just replicating ideas he stumbled across from others. He also had the incredible ability of taking consideration for what was working in his own business and further replicate or "doubling down" on the strategy. Early in his career, with just a single dismantling yard in operation, Johnson read Lee Iacocca had plans to shut down production plants for the Volare and Aspen models. Johnson figured if plants shutdown, there might be a lot of parts available. He and his friend Peter Kay cold called Chrysler procurement eventually taking a tour of the facilities and compiling their own list of parts to bid on post shutdown. The tactic worked, with Johnson bidding and winning several lots of parts for this yard. Once Johnson realized he could wholesale any of the parts his own yard couldn't move, Johnson replicated the tactic of bidding on large lots of parts from other production plant shutdowns. Replicating this source of inventory gave Johnson the ability to ramp up his own operations and add wholesale revenue streams at 80% gross margins. This time Johnson was observing and replicating what was working in his own business.

Pattern: Observe & Replicate

Observe and replicate also came into play with sales strategies early in Johnson's career. One time on the way to the airport, Johnson noticed that the Desoto Cab Company consisted of Volare and Aspen cabs. Johnson reached out to the owner of Desoto to offer wholesale replacement parts for his fleet. The owner of Desoto tested Johnson with a small order, in which Johnson had no problem fulfilling. As result Johnson won the business. After landing the Desoto Cab Company, Johnson replicated what worked by making the same offer to the owners of the Lux Cab Company and the Yellow Cab Company. The Lux Cab Company had a fleet of 400 hundred cabs, the Yellow Cab Company had a fleet of 600. He landed the business of both. In this instance, Johnson observed a successful type of customer, and replicated that book of business by finding more of that same type of customer.

III. Improving Throughput

One of the strongest patterns in Johnson's story was his intuitive ability to improve total throughput of a business. Most business leaders understand how to improve inventory turnover. Fewer business leaders truly understand how to improve throughput. Inventory turnover is as it sounds, the focus of maximizing how much and how fast inventory is moved through a business. Improving inventory turnover is certainly helpful as it improves the cash conversion cycle and the overall return on assets. Throughput is different. Throughput assesses the entire capacity of a business model. Throughput isn't visible just through the financial statements of a business. Throughput takes into consideration inventory, but it also incorporates sales channels, warehousing, order fulfillment, backend operations and everything else that makes the business hum. Improving throughput requires an intuitive understanding of how all the parts work together and knowing what to do to free the bottlenecks so the business can grow. Good business leaders focus on improving inventory turnover, great business leaders focus on improving throughput. And Willis Johnson understood throughput.

At an early age, Johnson worked at his father's dismantling yard. It was in these years where Johnson seemed to pick up the understanding of how to improve inventory turnover. Johnson understood inventory on the lot was tied up cash, and the way to make more cash was move (sell) the inventory. To move inventory Johnson took it upon himself to call body shops and mechanics to update them on what inventory was in stock. This led to more sales, and at a more frequent time rate. By turning over inventory faster, Johnson could accelerate the rate in which he bought more scrap cars (inventory), and cycle through the process all over again. Overall Johnson's early tactics to improve inventory turnover tripled the income level of his father's dismantling yard.

Johnson's savviness in improving inventory turnover carried over to his first personally owned dismantling yard. Having just specialized his dismantling yard into a Chrysler parts provider, business was picking up and Johnson quickly realized his greatest bottleneck was that of tracking his own inventory. To remove the bottleneck and optimize inventory management, Johnson spent $110,000 on a reel to reel computer to track inventory. With a computerized inventory system in place, Johnson's dismantling yard gained a leg up on an operational front. Johnson was able to track sales trends and quickly figure which parts were of greater demand. This allowed him to advantageously price parts based on local market conditions, optimizing the returns on which inventory he carried. Furthermore, once Johnson realized which parts were of lesser use, he quickly developed tactics to repurpose the parts altogether. For example, glass windows and door motors were taken from the car doors of less popular colors, making an otherwise idle piece of inventory, profitable.

"I was never afraid to spend money on technology if it could help us be more efficient."
– Willis Johnson

While the computerized inventory system was impressive, it was still more of a move to optimize inventory turnover. Johnson's first real step into optimizing total throughput came when he identified the bottleneck in his U-Pull-It yard. At the time, the U-Pull-It yard was turning over 100 cars per a day. Each car that was purchased required a title change and subsequent paperwork with the local Department of Motor Vehicles. For Johnson, 100 cars a day equated to 300 pages of paperwork that had to be completed for the DMV. To make matters worse, the paperwork was mailed out to U-Pull-It in cumbersome binders, with the legal requirement that any filing had to be finished within 24 hours of the initial purchase. U-Pull-It was quickly becoming the cash cow of Johnson's operations, and if he couldn't work out a solution to the bottleneck of title processing he would no longer be able to source inventory at a rate that kept with up demand. Instead of waiting for the DMV to develop a solution, Johnson built it for them. Deploying $40,000 of his own funds, Johnson built the state of California a computerized system to process the title needs for all DMV offices. Doing so, Johnson saved the DMV countless sums in both labor cost and mailing fees. In addition, the bottleneck for U-Pull-It was removed, opening up more throughput for the entire model.

Pattern: Improving Throughput

Jumping through history, the optimization of throughput for Copart really took hold in the second half of the 90's. At the end of 1996, Copart finished a $3 million project called "CAS" or Copart Auction Systems. This system allowed tracking across all Copart yards. The completion of the system equipped Copart with infrastructure that would scale as Johnson and his team added more yards. To leverage the system even more, Johnson and his team put CAS on the Copart website. This allowed customers to see a list of all vehicles for sale within the Copart system (an action that originally required faxing the equivalent of 8,000 sheets of paper every day to potential buyers). With CAS online, Copart next configured a way for buyers to submit bids through the website. All of a sudden Johnson and his team had removed the geographical barriers of traditional salvage car auction bids, allowing anyone in the United States to submit bids and become a Copart customer. Johnson had found another way to elevate the entire throughput capacity of the Copart business model.

IV. Prioritizing Customers

One pattern apparent for Willis Johnson was his consistency in prioritizing his customers. My favorite takeaway in studying Johnson was how he utilized the simple lessons of cleanliness and order from his time in the military to differentiate his dismantling yards. Unlike most yards at the time, Johnson would invest energy to line up cars in perfect orderly rows. Figuring customers shared his appreciation of cleanliness, Johnson steam cleaned and painted parts prior to organizing them on racks. To maintain the cleanliness in his retail store, Johnson would routinely repaint the store floors white. These actions were unheard of in the auto dismantling business. Yet cars lined in orderly rows, racks shelved with clean parts, and shiny white floors gave customers a non-comparable experience. Johnson was prioritizing the customer and differentiating the business simultaneously.

Cleanliness and order weren't the only ways Johnson prioritized his customer's experience. Johnson also happened to be one of the first in the dismantling business to piece out parts and not just the parts of the car. As Johnson explains:

> *"Typically if someone came into a dismantling shop and asked for a 46 liter motor, the shop would pull the whole motor out of a wrecked car and sell the motor and everything hanging on it, including the alternator, starter, regulator, smog pumps, air breather, carburetor, and distributor. I would sell just the motor for $275 at a time when equivalent motors were selling for $400."*
>
> *– Willis Johnson*

Transactions like this ultimately allowed Johnson to pocket $700 in total part sales compared to the $400 his competitors were generating for a single part and "extra's." Collectively this allowed Johnson to offer a lower price point on specific parts while simultaneously providing his customers with *exactly* what they needed.

As the Copart business evolved, so too did the ways in which Johnson prioritized the interest of his patrons. A big portion of Copart's customer base came to be insurance companies. When a car was totaled, the vehicle had to be towed, stored and finally auctioned all at various fee levels to the insurance company. Often the amount a salvaged vehicle fetched at auction failed to cover the tow, storage and seller fees thus leaving the insurance company underwater on the entire transaction. Johnson decided the best way to align his interest with his customers was to partner with them on the transaction. Copart enacted the Percentage Incentive Program or "PIP" that allowed him to simply keep 10-20% of each sale. In exchange Copart was on the hook for all cost associated with towing, storing and auctioning. Overnight this shifted the model of the salvage auctioneer business. Copart stood to make more on sales, but with the caveat of taking on variable risk in the cost structure. Nonetheless, Johnson bet that by prioritizing his customers interest, Copart would prevail and figure out how to make it all work.

Pattern: Prioritizing Customers

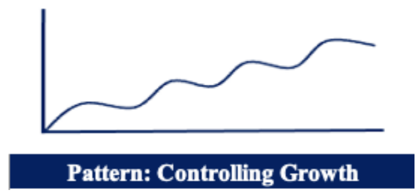
V. Controlling Growth

Perhaps most impressive about Willis Johnson was his pattern of strategically and methodically controlling growth. Most entrepreneurs charge ahead, operating with a progress at all cost mindset. Not Johnson. Johnson was methodical. Perhaps it was his experience in the military. Perhaps it was seeing the boom bust nature of his father's ventures during his upbringing. Either way, Johnson demonstrated a strong pattern of executing growth in a controlled manner, dictated on his own terms.

Johnson's first strategic growth move came in the form of an upstream acquisition of "Bob's Tow Service." Johnson and Bob were friends that knew each other from bidding at the same various salvage auctions. When Johnson found out Bob was interested in selling, he saw an opportunity to evolve his operations. Johnson understood that acquiring a towing operation would actually improve the return on his own dismantling yards. In addition, it was another stream of diversified revenue that came with exposure to big customers like the California State Automobile Association insurance company. The deal was done, albeit at pricier terms than Johnson wanted. Nonetheless, Johnson had a strategic asset to assist his salvage yard footprint.

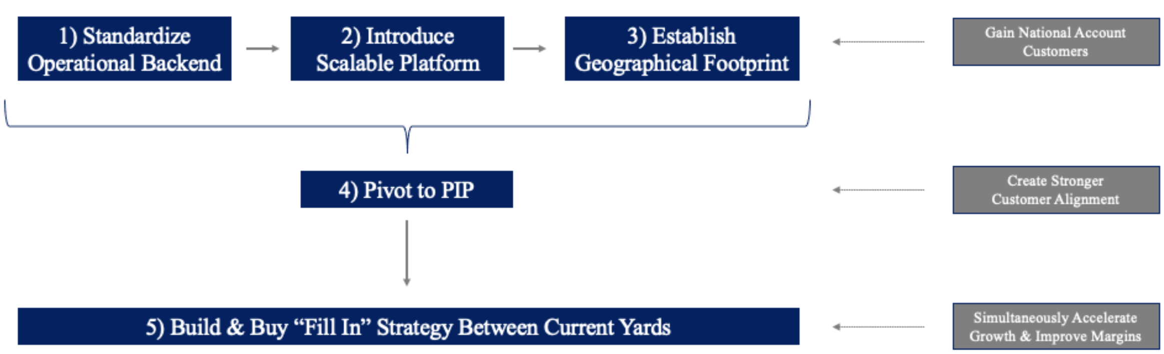
Yet the brilliance in Johnson's overall growth architecture really took shape in the 90's. At the time Copart and Insurance Auto Auctions (IAA) were both in a growth race, vying to own the salvage yard market.

IAA's strategy was to acquire as many locations as fast as possible with plans to run them independently and figure out integration down the road. Johnson opted for a centralized strategy with the focus on building a brand. Growth would be slower because each acquired location required a time period to integrate and transition the backend operations into the Copart operating system. However, what Johnson had correctly predicted was that a centralized structure served as a great operational advantage. For example, as volatility of gasoline prices hit, Copart was able to adjust tow rates immediately and simultaneously across all markets. In addition a centralized structure allowed Johnson and his team to offer consistent pricing for national customers across all markets. National clients liked this consistency, giving Copart a leg up on winning their business.



Where and how IAA and Copart grew also differed. IAA focused on big cities, often paying premium prices for acquisitions. IAA wanted profitable yards in good working order and often bought companies on pretax and after tax multiples. Copart focused on rural areas, opting out of high priced markets. Because Copart would standardize the backend operations, Johnson could acquire unprofitable yards, betting the Copart system would make them profitable locations. Instead of standard pretax and after tax multiples, Johnson computed acquisition offers based on land value and car turnover. Overall, IAA was aiming to please Wall Street with high clip revenue growth. Johnson and the Copart team set to control growth at a steady but lesser tempo, while generating an overall higher return on capital.

The real genius of Johnson came post pivot to the PIP program. PIP transitioned the interest of Copart to be fully aligned with its customers. However it also came at a cost. By forgoing standard towing fees, Johnson was eating the cost of vehicles that needed a long tow to any of Copart's salvage yards. After fortifying backend systems and completing platform integrations to improve throughput, Johnson shifted his growth focus on adding six to ten yards between each existing Copart yard. Closer yards reduced tow times and cost, improving overall margins and asset utilization. To execute this strategy Johnson opted for a buy or build campaign, buying when the opportunity was available, building when it made the most sense. Overall, "filling in" yards across the map provided a two for one punch where Copart was able to accelerate topline growth and simultaneously improve margins.



Conclusion

Willis Johnson was a phenomenal entrepreneur and operator. Studying leaders like Johnson and businesses like Copart help us recognize good patterns in other up and coming businesses. The business model of Copart was simple and in what some would was an overlooked industry. Johnson started with a single $75,000 dismantling yard, producing around $42,000 in sales a year. And yet today Copart has over 200 locations, and does more than $2.2 billion in sales a year. Quite a pattern worth studying...

Until next time,

M. Carter Johnson

P.S. – Hat tip to Andrew Wagner of Wagner Capital Road who originally introduced me to Copart a few years ago.