Bright Road Ahead for Investors in the Automotive Aftermarket

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As Americans keep close tabs on their budgets and have more time on their hands while at home, the thought of personally performing maintenance and repairs, such as changing a headlight, is no longer daunting.

This is just one example of how COVID-19 has transformed how automotive aftermarket companies conduct business and thrive during this unprecedented time. With consumers delaying the purchase of new vehicles and the ease of ordering parts and tools online, we expect COVID-19 to impact the automotive aftermarket products industry as follows:

Cautious consumers postpone their visit to the dealership.

As seen during the 2008-2009 financial crisis, the automotive aftermarket is countercyclical. Today, with high levels of unemployment and consumers across the country feeling economic pressure, they are likely to look for ways to save and delay big ticket item purchases.

While many will postpone the purchase of a new car despite massive manufacturer incentives (incentives were up ~20% YoY in April and May to try and drive new car sales), others will be more likely to turn to used cars. The average monthly payment for a used car in the first quarter of 2020 was $397, compared to $569 for new cars, offering significant savings especially considering standard technologies on today's used cars. With these savings, consumers can turn to the aftermarket to upgrade (performance parts, infotainment, off-road capabilities) and personalize (appearance, interior organization, accessories) their vehicles.

Once purchased, Americans will hold onto their cars for longer and rely on them more heavily. This is happening on top of an already aging car fleet even before the novel coronavirus. In 2010, buyers drove new cars and light trucks for an average of 5 years before replacing them, but in 2019 that number increased by 65% to 8 years, according to Lang iReport. While people have not been traveling as much during the pandemic, as lockdowns are eased, they are using their own vehicles more to avoid public transportation, ride sharing and air travel.

With these trends at play, there will be a greater need for both replacement and performance aftermarket products to maintain or customize vehicles.

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Detour to DIY.

In recent years, car owners embraced DIFM (Do It For Me) repairs, but as Americans stayed home during the COVID-19 pandemic more have adopted a Do It Yourself (DIY) mentality. Quarantining has given car owners the time and motivation to learn how to work on their vehicles themselves—whether for non-discretionary (maintenance and repair) or for discretionary (performance and appearance) projects. At-home work today is also less intimidating due to the availability of online resources that make it easy to identify the right parts and tutorials or videos that explain product installation.

Companies that sell directly online to enable DIY projects are seeing accelerated demand during this time. However, there is a chance that as life returns to a new normal and time becomes scarce again, there could be another shift back to DIFM.

In lockdown, e-commerce is the key to success.

Prior to the pandemic, e-commerce sales in the automotive parts aftermarket sector were hitting on all cylinders, reaching ~$12 billion in 2019.

As in many other industries, online shopping has soared during the lockdown period. Many middle market sellers have turned to Amazon to sell their aftermarket products online. In fact, online purchases of aftermarket parts and accessories increased by 53% from the first week of March to the week of June 2 in the U.S. and Canada.

Brick and mortar customer service is no longer a necessity as companies guide both DIYers and jobbers alike to order the right parts online. Educational materials, such as product comparison tables and instructional videos, empower the consumer.

LINCOLN PERSPECTIVE:

M&A has slowed with the pandemic, but once reinvigorated, likely in the fourth quarter of this year or the first quarter of next year, the long-term trends of the automotive aftermarket continue to make it an attractive investment sector.

The key differentiator for private equity investors is to build the infrastructure necessary to ensure automotive aftermarket success in this evolving landscape. By unlocking economies of scale through tuck-in acquisitions that lean on this infrastructure, buyers can expand market share and drive value.

Key components of the necessary infrastructure:

Brand recognition: Players with strong brand recognition and direct-to-consumer business models have experienced accelerated growth and command strong valuations. The goal is to have customers move from searching for a part they need to searching for the brand itself. To accomplish this, companies need marketing, search engine optimization (SEO), educational content, websites and e-commerce fulfillment capabilities.

Strong relationships / installer base: There needs to be a strong relationship between the aftermarket product company and the jobber or installer to ensure the customer experience remains strong and does not impact the brand. This becomes important as there is a possibility for a shift back to DIFM as stay at home measures relax.

Leading technology / product development: Aftermarket performance and technology upgrades can make a 5-year old car run like a new one. With such an attractive value proposition comes wider margins. Automotive product manufacturers that re-invest in the latest technology, engineering and product development will stay current with trends and latest model capabilities while differentiating from the competition.

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