

Automotive Aftermarket

Research Coverage Report

"Market Intelligence for Industry Players"

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Capstone Partners

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EXECUTIVE SUMMARY

INTRODUCTION

The \$197 billion automotive aftermarket is comprised of companies that manufacture, distribute, sell and install replacement components for automobile and light-vehicle segments. The market is relatively mature and is characterized by modest growth rates that are highly correlated with sales of new vehicles. Despite its maturity, the market is extremely fragmented, and many providers compete aggressively for retail shelf space and consumer spending.

The dynamics of the U.S. market have shifted considerably over the last decade, and the market is poised to experience major structural changes over the next few years. The entry of foreign producers and increased use of offshore manufacturing has elevated price competition and raised the importance of economies of scale and product depth. At the same time, new customer demand for specialty components and consolidation among retailers has increased the importance of brand equity. Market trends have also affected product retailers, which have witnessed the emergence of major category killers and on-line vendors that compete aggressively with traditional auto parts suppliers. This high level of competition is expected to intensify over the coming years.

Although there has been considerable consolidation among industry participants, Capstone expects that there will continue to be significant M&A activity over the next 18 to 24 months. The domestic market size and multiple consolidation opportunities will attract interest from both strategic acquirers and financial buyers.

THE AUTOMOTIVE AFTERMARKET

Automotive Aftermarket Universe – Capstone divides the market into two main segments based on the consumer: Do-it-Yourself (DIY) and Do-it-for-Me (DIFM), which are served by specific retailers and manufacturers. There are thousands of different participants, and both the retail and manufacturing universes exhibit considerable fragmentation. Although there has been significant consolidation within each, there are opportunities to achieve strategic and operational efficiencies through further market consolidation. Companies that possess strong brand recognition, high quality products, and service excellence will be the prime candidates for future acquisitions.

Market Opportunity – Capstone Partners estimates that in 2005, the total U.S. light-vehicle automotive aftermarket was approximately \$197 billion. We expect to see modest growth of between 3.0% and 4.0% over the next decade. Above-average growth has typically only been achieved through strategic acquisitions. Certain technology and specialty product segments, including electronics and custom components, have experienced significantly better organic growth rates, increasing sales at twice the overall industry average.

Customers continue to demand high-quality, low-cost products, which tends to favor low cost manufacturing centers like China and South America.

Key Growth Drivers – Although base market demand is expected to be moderate, some suppliers have been able to achieve above average growth. Key success factors include: 1) ability to compete on price in commoditized product segments through scope and scale economies and operating cost control; 2) increased shelf space with retailers by leveraging strong brand equity, superior product quality or niche product focus; 3) consolidation, or the ability to buy growth at a reasonable price.

Competing in a Global Economy – The entry of overseas manufacturers that produce low-cost, high-quality parts for the domestic market has increased competition. In response, many domestic suppliers have begun to move production into off-shore locations, including China and Mexico, to reduce operating costs and preserve margins. At the same time, consolidation among retailers has reduced shelf space and large distributors have begun to consolidate product manufactures. Capstone expects these trends to continue, increasing the value of low-cost production and broad product portfolios that include higher-margin, specialty products.

Retail Market Trends – The retail segment continues to evolve. Retailers are more often seeking manufacturing partners that can supply multiple product lines at competitive prices. Traditional DIY retailers have begun to expand their customer base by offering direct solutions for the DIFM customers. Internet distribution has also begun to capture share from traditional bricks and mortar channels. This intense competition has sparked a wave of consolidation among regional and super-regional players seeking scale benefits. Capstone expects the competitive landscape to continue to evolve as retailers adjust to changing market dynamics.

Growth in Part Inventories – Domestic and foreign automobile manufactures continue to roll out new models at a rapid pace. Growth in new vehicle models has lead to an exponential growth in the number of parts manufactured by suppliers and the number of SKUs that retailers are required to stock. Increased inventory requirements and administrative costs have contributed to reduced margins for the industry. Cost pressure will continue to effect margins for both manufactures and distributors, leading to additional consolidation and off-shore production.

Accelerated Consolidation – The automotive aftermarket is extremely competitive, and the provider landscape is constantly in flux. Capstone expects consolidation to continue over the next 18 to 24 months. Although there has been significant retail consolidation on a regional basis, there is still a large universe of local and regional targets. Increased competition from leading auto supply chains and large multi-product retailers will continue to put pressure on “Mom & Pop” stores. Manufactures face similar challenges. Slow market growth and declining margins have increased the need for higher volume production and broader product portfolios. Many market participants that can’t achieve significant scale; fail to carve out a profitable niche strategy; or partner with a consolidator will continue to loose market share.

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