



Automotive aftermarket outlook

A recession will boost near-term sales, but long-term challenges remain for the industry

Introduction

The current economic downturn bodes well for the automotive aftermarket, which is traditionally impacted less in these situations than the overall market and could be a relatively safer investment. Business should continue to remain strong in the near term for manufacturers that make and supply what is needed to repair and maintain older vehicles, including tires, brakes, shocks, and more.

That stability and reliability is one reason investors have shown a strong interest in the automotive aftermarket, and their interest has been rewarded. In the first half of 2022, stocks of publicly traded automotive aftermarket companies had a return of 18.5 percent.¹ In contrast, the S&P 500 finished the first six months of 2022 with a 20.6 percent loss.²

That reliable industry trend, however, is being challenged by the growing popularity of electric vehicles (EVs). With fewer moving parts to break and wear out, EVs have lower lifetime maintenance costs than vehicles with internal combustion engines. This dramatic shift will make many conventional aftermarket parts either obsolete or less needed. In this paper, we show how companies and investors that understand these dynamics can still do very well in this sector. In this paper, when we discuss EVs we are referring to battery electric vehicles (BEVs), since hybrids will continue to have internal combustion engines. We see hybrids as a stop-gap measure in the transition to full electrification.

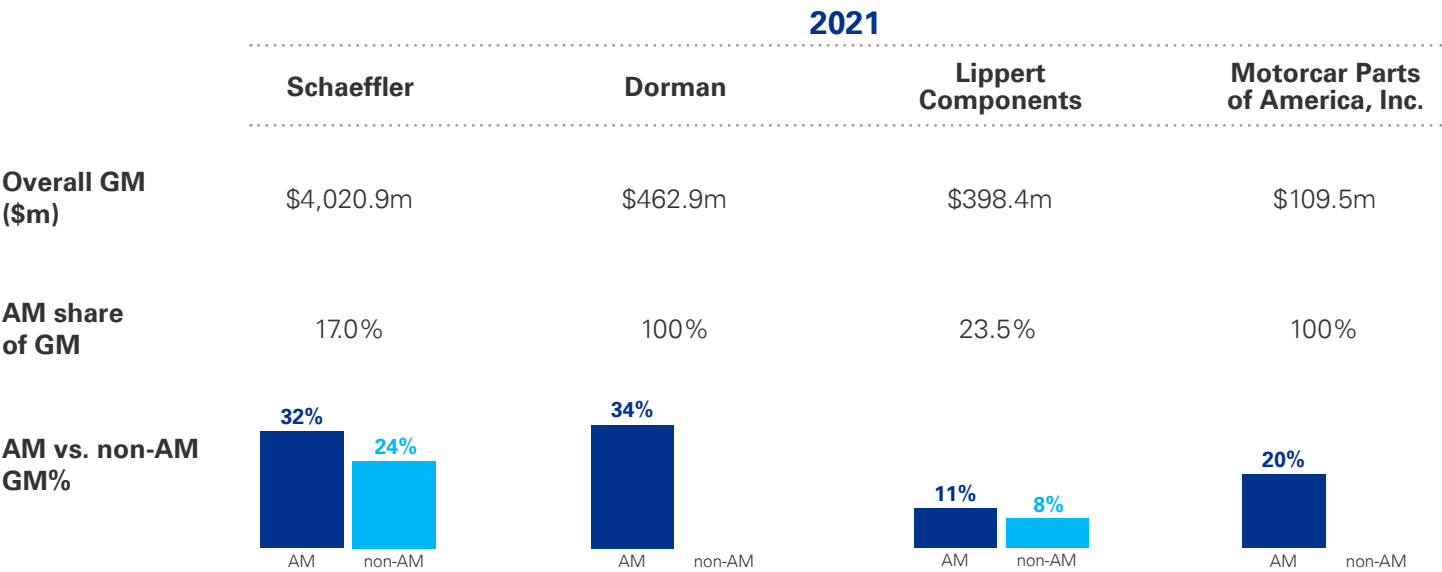
¹ Source: CSImarket.com

² Source: S&P 500 ends brutal first half '22 with largest percentage loss since 1970. Reuters. June 30, 2022.

The Auto aftermarket: near-term growth; long-term challenges

While automakers’ primary business is selling cars and trucks, the profit margin on vehicles is less than it is on aftermarket parts and accessories. The same can be said for Tier 1 suppliers, which can make anywhere from 3 to 10 percent more profit on aftermarket sales than their sales to original equipment manufacturers (OEMs).

Analysis of select companies shows a healthy aftermarket (AM) gross margin (GM)



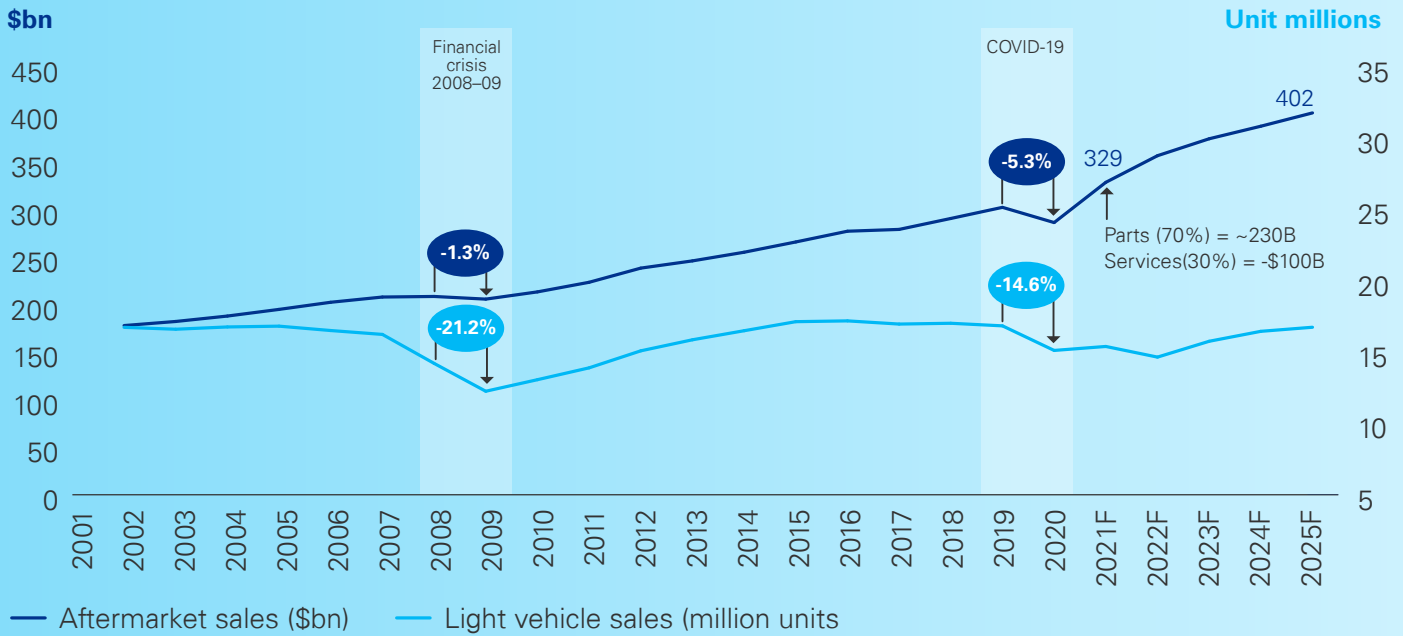
Sources: Annual Reports (10k); Detroit Bureau, Aftermarket news

Aftermarket parts is a sizable market, with some \$330 billion in annual revenue in the U.S. alone. Although the market experienced a slight decline during the last recession (2008-2009), it grew around a 4 percent compound-annual growth

rate (CAGR) until 2019 and is currently forecast to grow about 5 percent CAGR between 2021 and 2025, due to multiple factors as discussed in this paper later.³

³ Sources: Auto Care Factbook: 2015, 2021

Aftermarket sales remain fairly stable even when new vehicle sales drop sharply during times of economic distress.



Source: Auto care factbook 2015, 2021 and 2023, LMC auto

While the outlook for the auto aftermarket continues to be favorable for the foreseeable future, it does face certain headwinds with long-term implications.



Here are some positive and negative influences:

Positive: Vehicle age

Today's cars are lasting longer. The average age of light vehicles has increased from 11.1 years in 2012 to 12.2 years in 2021, and this trend is expected to continue. Older cars need more repairs and maintenance, and that need increases as they get older. More significantly, 85 percent of the vehicles in operation (VIO) today are more than four years old—a ripe time for aftermarket sales.

Positive: Vehicle miles traveled

Vehicle miles traveled (VMT) has rebounded to pre-COVID-19 levels, back to about 3.34 trillion in 2021 from a dip to 2.90 trillion in 2020. While a potential near-term economic downturn might impact VMT over the next one to two years, it is expected to stabilize to a YoY growth of 0.8-1.0 percent to over the long term, according to the Federal Highway Association.

Positive: Vehicles in operation

VIO has grown every year for the past 30 years at about 1 percent CAGR. That trend is expected to continue over the next decade, due to a reduction in scrap rate and a growing population. In addition, new-car sales are expected to reach pre-COVID-19 levels by 2023 as the economy normalizes. Increases in population, the average useful life of vehicles, along with the addition of new vehicles on the road are expected to drive VIO up during the rest of the decade. And the increase in VIO enhances the total available market (TAM) for the aftermarket business.

Negative: ADAS

Advanced driver assistance systems (ADAS) are becoming more common on new cars and are even appearing on less expensive models. About 40 percent of new cars sold are equipped with basic ADAS technology. Forecasts suggest that all new cars will have at least the next level ADAS technology by 2030. More prevalent and sophisticated ADAS will lower crash rates, adversely impacting the TAM for the crash-parts business. A part of the reduction in number of repairs will likely be offset by higher repair costs for more sophisticated vehicles.

Positive: Vehicle type

Consumers are increasingly choosing trucks and SUVs, which are typically 10 to 15 percent more expensive to maintain. SUVs and pickup trucks accounted for 65 percent of new vehicle sales in 2018 and are expected to account for about 80 percent of new sales by 2030.

Negative: Growth in EVs

While the number of EVs on the road today is relatively small, that is changing quickly, and this trend will have a negative impact over the long run. EVs currently account for about 5 percent of new car sales, and less than 1 percent of VIO in 2021. EVs are expected to account for about half of new car sales and less than 5 percent of VIO by 2030. All of which means the demand for ICE components will be seriously impacted.

The auto aftermarket consists of different part types

And these are likely to be impacted differently in the near future.

Nondiscretionary parts:

- **Wear and Tear parts:** These components—like tires, wheels, brake pads, windshield wipers—need to be replaced as the car is driven. These are recurring replacements, and the frequency of repairs depends on the number of miles traveled, as well as the behaviors of the driver (high speed, short stops, jackrabbit starts). This segment size is about \$100 billion, and its growth is dependent on VMT.
- **Crash parts:** These include those that would have to be replaced following a major or minor collision: fenders, doors, hoods, paint and windshields, as well as internal electronics and systems that might also be damaged. This segment size is approximately \$55 billion, and its growth is dependent on crash rates, part complexity, and vehicle write-off vs. repair.





- **Time-bound replacement parts:** These need to be repaired or replaced at regular intervals and include engine fluids, such as oil, antifreeze, and brake fluid, and parts like batteries, gaskets, alternators, and timing belts. This segment is valued at approximately \$28 billion, with its growth dependent on VIO.

Discretionary parts:

These are nonessential customizing accessories and tools—from the mundane to the exotic—and appeal to car aficionados and customizers. This category includes slip covers, trailer hitches, sports wheels, sound systems, auxiliary gauges, as well as repair and diagnostic equipment. This category is valued at approximately \$65 billion, with growth dependent on economic cycles.

Source: Auto Care Factbook 2023, Specialty Equipment Market Association 2022

Aftermarket revenues rely on different drivers based on types of parts

Part type		2021 Market size		Illustrative examples
Wear and tear parts	Parts that get worn away due to large number of miles traveled, frequency of use, driving behavior, etc.	~\$100B	<ul style="list-style-type: none"> • Tires, wheels, and misc. • Braking system 	
Crash parts	Parts that are impacted during collisions	~\$55B	<ul style="list-style-type: none"> • Collision, paint and body parts • Windshield 	
Time-bound replacement parts	Parts that need to be replaced/repared after a regular interval	~\$28B	<ul style="list-style-type: none"> • Chemicals (oil) • Battery 	
Discretionary parts	Nonessential products such as accessories, tools, and equipment	~\$65B	<ul style="list-style-type: none"> • Accessories • Tools and equipment 	

Accelerating trend: Faster adoption of EVs

The biggest factor affecting the automotive aftermarket is the growing popularity of EVs—and how quickly the transition to EVs will occur.

Encouraged by various incentives, consumers are becoming more inclined to purchasing EVs. In 2021, EVs accounted for less than 5 percent of new car sales and less than 1 percent of VIO. But by 2030, EVs are expected to account for about half of all new cars sales and represent less than 5 percent of VIO.

The Inflation Reduction Act of 2022 changed and extended some federal tax credits to promote the domestic production and sale of affordable EVs. And a number of other factors are

converging to drive more EV sales, including declining total cost of ownership for EVs, improved EV range, and expanding charging infrastructure. Another significant development is the launch of several new mass-market focused models, like pickups and SUVs. These EVs should drive adoption in suburban and rural markets, which are outside of the EVs' traditional markets.

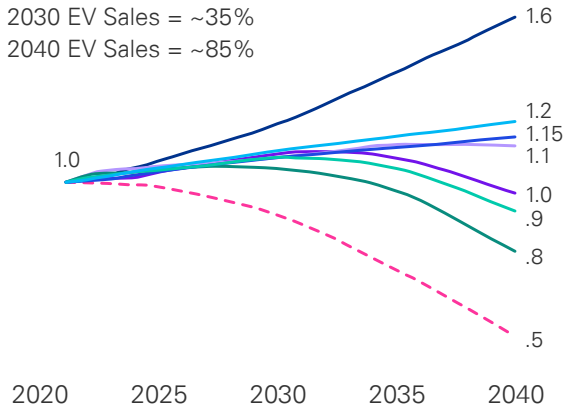
It should be noted that companies supplying ICE components to OEMs have been negatively affected as EV sales are expected to expand quickly. However, that is very different with the suppliers of aftermarket parts, where ICE suppliers continue to do well.



Impact on aftermarket demand is expected to vary by level of EV adoption across part types

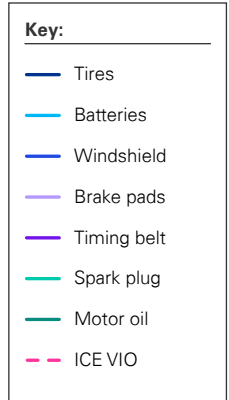
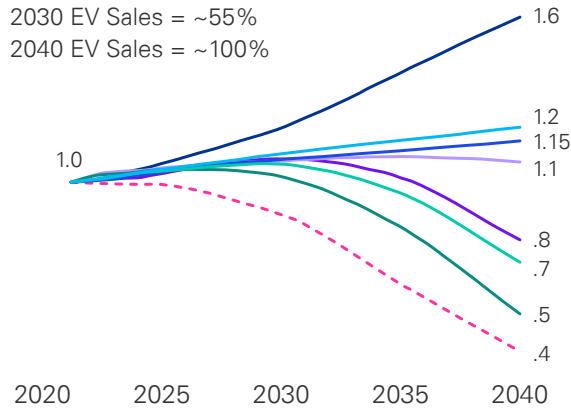
Base case:

2030 EV Sales = ~35%
2040 EV Sales = ~85%



Stretch case:

2030 EV Sales = ~55%
2040 EV Sales = ~100%



Time-bound replacement parts

- ↓ As VIO shifts towards EVs, demand for parts such as motor oil, and spark plugs is expected to fall.
- ↑ Parts such as auxiliary batteries are expected to consistently grow as their replacement is not dependent on powertrain/VMT.

Wear and tear parts

- ↑ EV powertrains will drive demand for parts such as tires due to higher wear and tear.
- ↓ Advanced tech such as regenerative braking will reduce reliance on traditional brakes; reduce brake pad replacement requirements

Crash parts

- ↔ ADAS tech will reduce collisions and will impact demand for few parts.

Faster adoption of EVs, with their overall lower maintenance requirements, could change the dynamics of the auto aftermarket. EV's lack of internal combustion engines (ICE) components eliminates costs related to periodic oil changes, spark plug replacement, new catalytic converters, etc. EVs can boast maintenance expenses that are about 40 percent lower than gas-power cars over their lifetime.

Consequently, the dynamics of the automotive aftermarket are likely to change over time and by type of part:

- Demand for ICE-specific parts—motor oil, and spark plugs, as well as engine accessories used to enhance ICE performance—is expected to fall as VIO shifts toward EVs. In fact, many aftermarket companies will begin to phase out their ICE engine parts to make room for EV parts. Likewise, crash parts may see a decline in demand as more cars are outfitted with autonomous vehicle and ADAS technology.
- For aftermarket parts shared by both EVs and ICE, demand is likely to be mixed. Sales of tires, for example, will likely

increase, since EV powertrains produce higher wear and tear on rubber. Demand for parts such as auxiliary batteries, which start ICE vehicles and power the accessories on EVs, are also expected to grow, as their replacement is not dependent on powertrain or VMT. On the other hand, advanced technology—like regenerative braking used on EVs and hybrids—reduces wear and tear on traditional brakes and extends the life of brake pads.



Our outlook for the aftermarket varies by time horizon

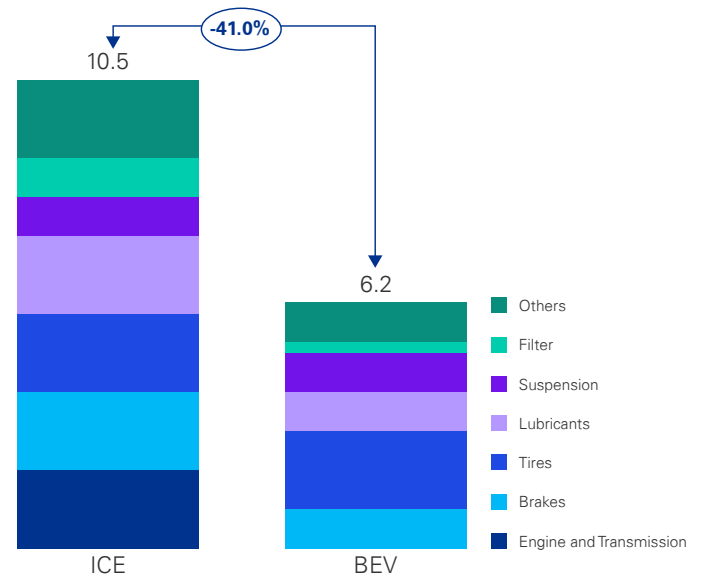
	Short-term (1–2 years)	Medium-term (3–10 years)	Long-term (2030 and beyond)
Non-Discretionary Parts	Time-bound replacement parts Time-bound replacements are expected to continue irrespective of the economic downturn in the short term.	As the economy stabilizes, the replacement parts market is expected to grow.	Increased EV and ADAS tech is expected to add new parts with higher spend.
	Wear and tear parts Wear and tear parts sales might witness a slowdown due to economic downturn.	As the economy stabilizes and there is an increase in VMT, wear and tear parts market is expected to witness growth.	With increased EV and ADAS penetration, reduced maintenance requirements are expected to slow down aftermarket sales.
	Crash parts Vast majority of car parts have little to no ADAS.	As the economy stabilizes, the crash parts market is expected to witness growth, but increased ADAS adoption might result in lower collision rates.	High ADAS penetration might have a negative impact on crash parts sales.
Discretionary parts*	Inflation and slowdown might have a negative impact on the aftermarket sales of accessories	As the economy stabilizes, the discretionary parts market is expected to witness growth.	More accessories are being made available and more OEMs and channels are offering them.

* Includes approximately \$36B of specialty equipment spend not covered by Lang report.

Key drivers for low EV maintenance costs are:

- Absence of ICE components reduces service cost pertaining to frequent oil changes, spark plugs, catalytic converters, etc.
- While an ICE vehicle has ~2,000 moving parts, a BEV typically has ~20
- Regenerative braking reduces wear and tear of mechanical brakes

Scheduled Maintenance Costs, by component type⁴, powertrain in Cents/mile



⁴ Engine and transmission – Includes spark plugs, oxygen sensor, transmission service, timing belt and accessory drive belt; Brakes – Includes Brake pads, rotors and calipers; Tire – Includes tire rotation and replacement; Lubricants – Includes engine oil, brake fluid, engine coolant and EV battery coolant; Suspension – Includes shocks and struts; Filters – Includes oil, cabin air, engine air and fuel filter; Others – Includes multi point inspection, wiper blades, headlight bulbs, HVAC services and starter battery

⁴ Source(s): Comprehensive Total Cost of Ownership Quantification for Vehicles with Different Size Classes and Powertrains, Argonne National Laboratory, May 2021

Where to place your bets

Private-equity (PE) firms have historically invested heavily across the aftermarket value chain because of its consistency and positive returns. Indeed, 2021 saw 36 PE deals in the auto aftermarket space. Recent deals include All Star Auto Lights, a portfolio company of Atlantic Street Capital, acquiring Blackburn OEM Wheel Solutions, a supplier of steel and alloy wheels;⁵ private equity-backed AGS Company Automotive Solutions LLC, a maker of automotive aftermarket parts, purchasing Motive Products, a manufacturer and distributor of auto and motorcycle tools and equipment;⁶ and Hidden Harbor Capital Partners completing a deal for Dayco, an engine products and drive systems supplier.⁷

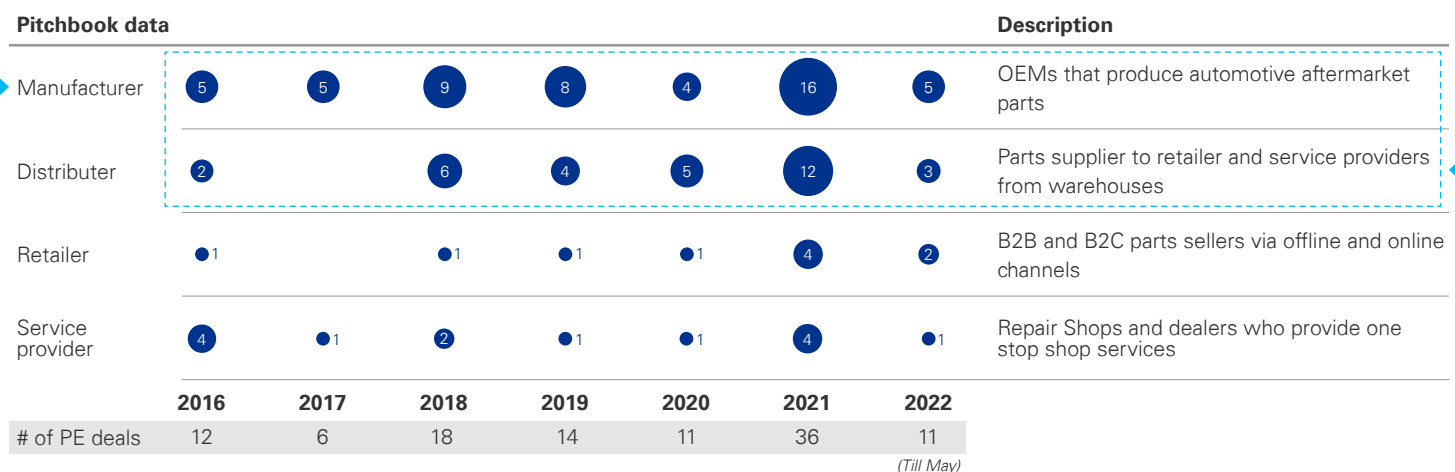
However, as the aftermarket landscape transforms, key auto-parts players will face consolidation or seek alternate opportunities. For example, as EVs gain a greater percentage of VIO, the need for rubber engine belts, such as timing and drive belts, will fall. At the same time, belts tend not to be very efficient in transferring energy. As regulators require the auto industry to become more fuel efficient, OEMs will be looking to replace belts with more mechanically efficient designs. Belt makers will need to either consolidate or pivot to supplying other industries.

Ultimately, the dynamics of the auto aftermarket will evolve, with growth eventually steering toward EV-specific and powertrain agnostic parts. Demand for ICE components will start to diminish at varying rates over the next couple of decades—depending on their replacement cycles in the life of the vehicle.

Given rapid changes in the auto industry, investors in the automotive aftermarket will need to be cautious about where they place their bets. It is not always going to be a safe bet, and past performance is not always going to be an indication of the future.

- Manufacturers closely tied to ICEs will become risky at various time horizons (depending on the part replacement cycle) but will generally remain a viable option for the near term. Opportunities for consolidation among these suppliers will likely increase.
- Makers of powertrain agnostic parts, like tires, lead acid batteries, and windshields, will remain a safe bet for the long term and can generally weather economic downturns. The same outlook applies to discretionary accessories. In fact, some of these parts may benefit from the EV revolution.
- For the long term, look for suppliers that are gearing up for the accelerating shift to EVs.

PE Investment in auto aftermarket players, by value chain



“Branded suppliers who focus on innovation, introducing new products, and expanding existing product categories are best positioned for future growth.” – Jeffries

“...distributors performed particularly well in the public markets as a result of shifting consumer behavior and increasing engagement in these sectors.” – Jeffries

Source(s): Pitchbook (data pull 16 Jun 2022); Automotive Aftermarket, Jeffries

⁵ Source: “Atlantic Street Capital-based All Star Auto Light acquires Blackburn OEM Wheel Solution,” Private Equity Wire. August 8, 2022.

⁶ Source: “Norton Shore automotive aftermarket manufacture AGS Co. acquires California firm,” MiBiz. September 6, 2022.

⁷ Source: “Car talk: Investcorp, Clearlake, Atlantic Street snatch up parts makers,” PE Hub. August 19, 2022.

How KPMG can help

KPMG is a recognized leader in delineating critical trends in the automotive sector—mobility, autonomy, electrification, etc. We have helped top companies in the industry plan and execute plans to make the most of these trends.

Our data-driven approach allows us to quantify the impacts of trends across the value chain on automakers, dealers, suppliers, and other players so they can identify and prioritize emerging opportunities. We then assist clients in defining technology investment and development roadmaps to pursue these opportunities.

In addition, we support clients with operating-model and business transformations to prepare their organizations for building new types of products and doing business in impactful new ways.

For automotive aftermarket companies and investors, we offer the following services across finance, accounting, tax, technology, HR, commercial, and operational functions:

- Buy-side and sell-side diligence for investments in the aftermarket
- Revenue and SG&A synergy opportunity identification
- Carveout, separation, and TSA assistance
- Transaction execution from pre- to post-close
- M&A advisory and capital raising
- Performance improvement for aftermarket companies



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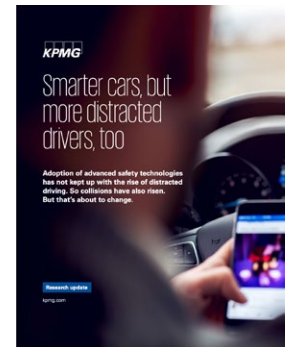
Place your billion-dollar bets wisely



Will autonomous vehicles put the brakes on the collision parts business?



Stop-start: Auto aftermarket sales have stalled because of COVID-19, but a demand surge is on the horizon



Smarter cars, but more distracted driver, too

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