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## The Future of The Aftermarket: A Shift in Perception

*By Tom Marx and Tom Herndon*

The image of the aftermarket as a sound financial investment, or even as a possible career path, is changing. Both Wall Street and Main Street are beginning to appreciate the high-quality, technologically advanced *respect* being earned by one of the major industries – an industry that continues to expand despite the perception of a softened economy.

Leslie Armitage of The Carlyle Group (alongside Greg Guvett of JPMorgan)\* spoke at the recent Global Automotive Aftermarket Forum in Chicago. She stated that from Wall Street's perspective, financial markets are becoming bullish on the aftermarket auto parts industry – and for some very sound financial reasons:

1. Good cash flow
2. Steady (healthy and consistent) growth
3. Low capital equipment investment required (as compared to technology and other industries, where manufacturing equipment is not only expensive, but can quickly become obsolete)
4. Barrier to entry is high (since service levels are high and knowledge of the aftermarket is critical to success)
5. Demand consistently increases (more vehicles, more miles driven, longer commutes)
6. Higher ratio of luxury vehicles and SUV's
7. And more

It's not all rosy. Leslie observed several areas of concern, including:

1. Brand relevancy – the ongoing challenge of encouraging the channel to buy branded products, not just the low-price leader
2. Getting the right (good) people – those with knowledge about the product and a passion for service and excellence
3. Paying competitive salaries – which keeps good people in a competitive job market
4. Training – needing even more commitment
5. Focusing – on the important concerns of product quality and growth

(continued)

She observed that management is becoming more aware of these concerns and that the companies that have been making improvements are growing organically and becoming ripe for consolidation or acquisition.

Leslie made it very clear that she's referring to the AFTERMARKET, not OE parts suppliers. OE suppliers continue to be plagued with a variety of OEM issues, especially the ongoing squeeze on profits. The investment world is starting to see that the aftermarket is less prone to cyclical issues than OE suppliers, which is why many OE suppliers are working hard to gain a foothold in the aftermarket.

Finally, for Johnny and his Mom, not only are salaries increasing in the industry, so is the prestige of working as an Automotive Technician (they're not called mechanics anymore).

The interest in autos and trucks, for Gen X and Y, is being driven by a burgeoning sport compact car phenomenon. Plus, new technology is encroaching (albeit SLOWLY) into the industry, even at the independent service dealer level.

The University of the Aftermarket is providing state-of-the-art education, training, guidance – and job placement. Today's graduates from the automotive schools are entering the market with the scientific and intellectual cachet of an Electronic Technician, as opposed to the yesterday's view of graduates entering the market as Auto Mechanics.

Remember, it's estimated that by 2010, over 40% of an automobile's content will be electronic. In fact, MIT has rated Delphi as the most high-tech Automobile OEM on the planet – for the second year in a row. As a major supplier to the OE and to the aftermarket, Delphi is a great example of where the market is going – and for that matter, is setting the bar for technology pretty high.

We can all see the writing on the wall: consolidations and acquisitions will continue. This is both a time of opportunity and of challenge. The opportunity will result from more readily available capital, which will fuel acquisitions and expansion. The challenges will come from a continually shrinking market of potential customers, as well as finding, training and retaining skilled labor.

We were very encouraged to hear Leslie and Greg's perspective at GAAS. All in all, despite the challenges of a growing market, it looks like a positive future.

Automotive Aftermarket not sexy? Just watch the "Fast and Furious!"

\* Established in 1987, The Carlyle Group is a private global investment firm that originates, structures and acts as lead equity investor in management-led buyouts, strategic minority equity investments, equity private placements, consolidations and buildups, and growth capital financings. The Carlyle Group currently has over \$15 Billion of capital under management. Leslie L. Armitage is a Managing Director focused on U.S. buyout opportunities in the consumer sector. She heads the U.S. consumer team and is based in Washington, DC. <http://www.thecarlylegroup.com>

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