pwc

strategy&
Formerly Booz & Company

DIFM Outlook 2025: A Dynamic Battleground

Automotive Aftermarket Suppliers Association

About AASA

AASA (www.aftermarketsuppliers.org) exclusively serves manufacturers of aftermarket components, tools and equipment, and related products which support 710,000 employees in the United States. AASA is a recognized industry change agent – promoting a collaborative industry environment, providing a forum to address issues, and serving as a valued resource for members. AASA is the light vehicle aftermarket division of the Motor & Equipment Manufacturers Association (MEMA). "AASA, The Voice for the Automotive Aftermarket Supplier Industry"

About Strategy&

Strategy& (*www.strategyand.pwc.com*) is a leading global management consulting firm (formerly known as Booz & Company), helping the world's top businesses, governments and other institutions through foresight and knowledge, deep functional expertise, and a practical approach to building capabilities.

Introduction

This report, *DIFM Outlook 2025: A Dynamic Battleground* is a strategic analysis of the U.S. automotive aftermarket. Its objective is to provide an integrated view of the factors that will impact this industry over the next decade with a particular focus on the Do-It-For-Me (DIFM) segment and all the connected participants.

The insights and findings in this report are based on extensive primary and secondary research. To determine and analyze the most important strategic issues for senior executives' agendas, we completed interviews with approximately 30 Automotive Aftermarket Suppliers Association (AASA) members, 10 top executives at key channel players, and several industry experts including OEMs, private equity firms, and research companies. We also gathered views of more than 100+ professional technicians across the U.S., ~50 new-vehicle dealers and ~1000 motorists, through in-person interviews and online surveys. Additionally we built analytical models to size and assess the evolution of the independent automotive aftermarket based on forecasts of light-vehicle sales, vehicle PARC, replacement rates, vehicle miles traveled, and parts prices.

This report is organized into eight sections plus an appendix:

I. Executive Summary

II. Frequently Asked Questions (FAQs)

III. DIY vs. DIFM

IV. Future DIFM Market Structure

V. The Independent Shop of the Future

VI. Evolving Consumer Expectations

VII. Distribution Change

VIII. Implications for Suppliers

Appendix: Additional Analyses and Supporting Data

I. Executive Summary

Four years after the AASA Aftermarket Outlook 2020 report was published, this new report once again investigates how the industry is likely to shift over the coming decade, but this time with a particular focus on the Do-It-For-Me (DIFM) market. Current views on the future of the industry range far and wide, including extreme projections about the decimation of Do-It-Yourself (DIY) maintenance and repair, or even of the entire independent aftermarket. This report offers an objective, considered perspective based on a strong foundation of data and analysis.

How much will the industry change over the next decade? In a word – **plenty**. The upheavals brought about by parts longevity, aggressive channel consolidation, SKU[1] proliferation, LCC[2] sourcing, and internet price transparency are still playing out. On top of these, the future holds additional challenging twists and turns. Most characteristics of this slow-growing market are enduring, with the major shifts gradual by nature. **Yet, important changes are underway that will affect all involved and make every aspect of the business very different in ten years.** The basic structure of the DIFM industry will not change much – predominantly single-outlet, non-franchise shops. However, how those shops serve customers, how they work on vehicles, and how they are served by their channels and suppliers will be transformed, largely by technology. It will not be business as usual in the DIFM world. The means to survive and compete are shifting; the changes are already underway. The best shops will look and feel dramatically different from today, and the unsuccessful and unchanging shops will fade away.

Five key themes stand out when viewing the future of the industry from a DIFM perspective.

1. **DIY vs. DIFM**. The **DIY parts market will remain basically flat at $20B** in absolute terms. But it will decline as a portion (26% in 2013) of the overall aftermarket parts market[3], dropping about one percentage point every three years through 2025. Increasing vehicle complexity, an aging populace, and changing consumer preferences will all contribute to the decline. More complex parts and parts that are harder to repair will see greater declines than traditional maintenance parts. However, economic necessity, sustained requirements for basic maintenance, and the large percentage of older vehicles in the PARC[4] will help preserve the substantial DIY parts market at its current dollar level through 2025. The growth in aftermarket parts will be in the DIFM market, which will rise from $56B in 2013 to $70B in 2025.

[1] SKU – Stock keeping unit
[2] LCC – Low cost country
[3] U.S. light-vehicle aftermarket parts excluding labor, warranty/recall parts, collision parts, OTC telematics, tools, equipment, tires, and oil
[4] PARC refers to the pool of vehicles in operation

2. **Future DIFM Market Structure**. Today the DIFM market represents 74% of total parts sales and it will grow to 78% by 2025. **New-vehicle dealers will pick up aftermarket parts volume (about $4B) and share, growing from 17% ($13B) in 2013 to 20% ($18B) in 2025**. Over this same time **the non-dealer DIFM shops will barely expand their share of the aftermarket parts market, but will grow parts volume approximately $9B**, going from 57% ($43B) to 58% ($52B). Several factors such as more complex vehicles, better access to OEM training, and relatively more sophisticated marketing favor dealers, but other essentials such as price and convenience work to advantage of non-dealers. Importantly, dealers only have around 30% of the repair bay capacity today, and realistic projections of future capacity restrain their potential share gains. Non-dealer DIFM shops that are sub-scale and unable to make the investments (technology tools, equipment, talent, shop appearance, customer marketing and relationships) required to compete in the future will lose business to larger, sophisticated shops, and some will even disappear. An increase in brand-specialist shops is also expected in the face of greater vehicle complexity. Finally, independent DIFM chains are not expected to capture much share, even under the most aggressive scenarios.
3. **The Independent Shop of the Future**. The successful independent DIFM shops in ten years will be very different from today in several respects; most notably they will be **transformed by technology**. They will utilize advanced diagnostic and service support devices to make their operations more efficient and reliable, while helping address the qualified technician shortage. The workforce itself will be reshaped by technology. Technology will profoundly revamp how customers are managed. The best shops will offer an impressive suite of digitally-enabled marketing and customer management capabilities that rival those of the best companies in leading industries today (e.g., casinos, apparel retailers, and drug stores). **Building these capabilities will require capital and thoughtful investment choices and managerial dexterity**. Outlet scale, service quality, operational efficiency, smart pricing, and adept marketing are some of the keys to success. Shops that are unable to make the right investments and transform themselves will not be able to compete in the future.
4. **Evolving Consumer Expectations.** End customers' expectations are being influenced by services and conveniences provided by other industries and growing exposure to advanced, digital technology-enabled experiences elsewhere – whether it be making a purchase on Amazon, catching a ride with Uber, or arranging a trip online. These expectations are much higher and different than what the automotive aftermarket offers today, and they are growing exponentially due to accelerating technological progress. All aspects of the DIFM experience (pre-service, service and post-service) will be refashioned in response. **DIFM service providers will have to change their operations and adapt to these new expectations or face peril**. Suppliers will also need to reform how they market and manage their brands and services in response. **This represents an important opportunity for suppliers to create consumer pull for their brands and drive traffic to the successful shops.**

5. **Distribution Change**. Distribution consolidation has been the biggest change driver in the industry for some time now. It will continue, and continue to stress suppliers. Substantial power and economic value have shifted from suppliers to channel partners. All channel partners face much tougher roads ahead. They must now find different ways to keep delivering shareholder value growth, besides simply extracting concessions from suppliers. As the market shifts gradually from DIY to DIFM, channel players are working to capture more DIFM share. The winners will need to triumph over peers to succeed, and competition among them is intensifying. Some have difficult tasks to successfully integrate acquisitions they have made in response to these dynamics. And they all have to develop more sophisticated and complex supply chains and merchandising to deal with several tall challenges – SKU proliferation, multiple target customer segments (commercial versus retail) with very different needs, online business models, declining competitiveness of 3-step models, and better use of data and analytics. Some will not survive the ensuing battles; **only the differentiated and nimble will prevail.**

It is clear that suppliers cannot be complacent when confronted with all the projected DIFM market changes. They must reevaluate their competitive positions and plans and determine how best to respond to, or better yet, take advantage of the market dynamics. The following imperatives can help suppliers refine or develop their own specific winning strategies, given this context of industry dynamics.

A. **Non-dealer DIFM**. *Understand how the changes in the non-dealer DIFM market will affect your business and how you need to respond. Have the strategies and tools in place to connect with and influence service providers. Align with the right channel partners.*

B. **Channel**. *Determine how best to help channel partners become more successful in the DIFM market and make your business uniquely indispensable to them. Know how to plan for the potential channel winners and losers in serving the DIFM shops and how to help them with their strategies.*

C. **Dealers**. *Create a business that effectively reaches new-vehicle dealers directly with OES business or through independent aftermarket channels for the OES market, if you serve it, and/or for non-OES product, as they increasingly need it.*

D. **Scale**. *Assess the scale required to be successful. Define and select among the realistic organic and inorganic options for growth needed to achieve this scale. Decide whether or not international expansion is appropriate.*

E. **Differentiated Value Proposition**. *Ensure you are competitive on all the basics – cost, quality, delivery, and channel /customer services and support. Establish a truly differentiated and powerful value proposition that will deliver attractive returns and growth. Consistently work to make it stronger.*

Suppliers who can comprehensively and confidently address these imperatives will fare well as the industry evolves. Those that cannot should objectively assess what changes are needed to fortify their businesses. The shifting DIFM battleground will not be kind to companies that fail to evolve.

II. Frequently Asked Questions (FAQs)

1. With factors such as declining replacement rates and the increasing "Uberization[5]" of transportation, will the size of the aftermarket shrink dramatically?

The dollar volume of the U.S., light-vehicle, aftermarket parts market will grow very slowly at an estimated 1-2% per year, as it has in the past. As vehicle quality has improved, replacement rates have declined and this trend is continuing. However, the prices of replacement parts have also increased due to new technology and materials. The decline in unit volume from lower replacement rates is roughly offset at the aggregate market level by rising parts prices. New vehicle sales, although much more cyclical, and the vehicle PARC will continue to grow with the economy, fueling overall growth in the parts market. Threats of increasing urbanization or the "Uberization[5]" of transportation are overblown. In the next ten years the market will not experience any major decline due to factors such as a reduction in vehicle miles traveled (miles traveled in a year per vehicle) or younger consumers not desiring to purchase vehicles. (*Refer to Appendix A4-5, A8, A18*)

2. With increasing technological complexity of repairs, an aging motorist population, and changing consumer preferences will the DIY market decline significantly? What will be the decline?

As a portion of market, DIY will continue to decline as it has in the past at a rate of about one percentage point every three years, from about 26% of the market in 2013 to 22% in 2025. Over this period DIY parts will stay fairly constant in dollar terms at around $20B. Most of the market growth during this period will come from DIFM. Increasing vehicle complexity, the aging population, generational preferences, and greater overall affluence contribute to the DIY share decline. In addition, online information will pressure DIY parts prices, as well as DIFM parts prices. On the other hand, economic necessity, a large PARC of older vehicles, and more accessible technology will help to sustain DIY business. (*Refer to pages 11-12*)

3. Is the independent aftermarket (IAM) going to decline and die at the hands of new-vehicle dealers?

New-vehicles dealers will gain about three points of aftermarket parts share worth about $4B by 2025. During this time non-dealer DIFM shops will grow their parts sales by approximately $9B, but their aftermarket parts share will only increase from 57% in 2013 to 58% in 2025. Dealers are more motivated than in the past to grow their parts and service business due to the new vehicle customer retention benefits and declining new

[5] "Uberization of transportation" refers to technology-enabled transportation solutions similar to the one pioneered by Uber using smartphones to bring together consumers and drivers efficiently; some people speculate that increasing demand for such services could reduce vehicle ownership.

vehicle sales margins. Advanced technology and telematics will have a positive but muted impact on dealers' market share. The dealers' upside will be bounded, because they have (and will continue to have) bay capacity constraints on how much service business they will realistically capture by 2025. Non-dealer DIFM shops must substantially upgrade their technical prowess, marketing capabilities, appearance, and image to serve modern vehicles and customers, and to compete effectively against dealers. They will need help from suppliers and channel partners to do so. (*Refer to pages 15-22*)

4. **Will more of the aftermarket shift toward e-tailing, as it has in other industries? What will be the impact on brands and brand-building**?

   E-tailing will continue to grow but will represent a small portion of the market. E-tailing was about $3.4B or 5% of the U.S. light-vehicle aftermarket parts market in 2013. The amount has been growing more quickly than any other industry channel at about 13% per year, and it should continue to grow, although at a slower rate. The large majority of the e-tailing volume, approximately 80%, is for the DIY market. In DIY a very large and growing portion of shoppers go online to research aftermarket parts, but most do and will still purchase in a physical store. DIFM customers also will increasingly research parts and services online.

   With the extensive and expanding online activity by customers, suppliers have a chance to build their brands like never before. Great content and online presence are the keys to building and maintaining brands today. The inverse is also true, as manufacturers with weak online positions will see their brands erode much quicker than in the past. (*Refer to pages 36-38*)

5. **What effect will increasing price transparency due to the internet have on DIFM shops?**

   Internet-driven price transparency will undoubtedly compress parts margins, but the impact will vary by type of part, type of customer, channel, and purchase situation. In general, DIFM service shops will likely need to reduce parts mark-up and raise labor rates to more accurately reflect the value-added economics. Large-scale business displacements should not occur. The market will still need the vast aftermarket service channel. However, the shops that do not manage prices well will be hurt. Also, suppliers and channel partners will need to become more skilled at price management, carefully ascertaining where and why competitive offerings will affect pricing, and then responding appropriately and precisely. (*Refer to page 37*)

6. **As vehicles become technologically more complex, what will be the impact on the independent service shop of the future? Will they be able to make the required investments in diagnostic and service tools to handle these more advanced technologies**?

   Advanced vehicle technology will continue to challenge the non-dealer shops and technicians, particularly on the newest models and the most complex vehicle systems, as electronic content mushrooms. However, the non-dealer shops have proven to be resilient in adapting to technology shifts in the past and should be in the future. Improvements in diagnostic equipment functionality and cost will help in this regard. Also, with the average age of the PARC at over 11 years, the most advanced vehicles will always be a small portion of the market. The independent shops will likely resort to more specialization (e.g., by make or type of service) to help adjust to technology changes.

   Furthermore, OEMs are unlikely to succeed in significantly restricting parts access or repair information to the independent aftermarket – the barriers, both legal (as with Right to Repair) and customer satisfaction (preventing customers from utilizing the aftermarket would damage a brand), are just too great. This does not mean the battle is over or the enormous effort required to protect the aftermarket can be taken for granted. The industry undoubtedly will need to work vigilantly to thwart OEM encroachment and technical barriers on the aftermarket. OEMs and their dealers may end up gaining some ground, but ultimately dealers cannot possibly (and do not want to) service the entire PARC, and OEMs' actions will have to be legal and logical. (*Refer to pages 19-20*)

7. **With the advent of telematics, will independents be able to compete effectively with the OES channel?**

   Telematics may provide some advantage to dealers, but the impact on the non-dealer shops will be marginal. When dealers, or independents for that matter, provide good, timely marketing of service offers, they are effective. However, telematics itself does not necessarily bias the market to dealers, since in-vehicle prompts (the most common type of notification) simply motivate owners to take their vehicles to their preferred shop, which most of the time is an independent. In addition, powerful, OEM-independent, aftermarket telematics solutions are already available, and more are coming. Their costs and functionality will improve. As this happens, independent shops also should be able to take advantage of telematics. More important than the telematics is the marketing prowess to provide consumers with compelling service offerings – independent shops will need to build up their marketing capabilities to compete. Suppliers and channel partners should help them. (*Refer to pages 20-22*)

8. **How will professional repair shops find the skilled technicians they need in the future? How will professional technicians be able to keep up with the technology?**

The independent professional technician of the future will be very different from today. They will still need the ability to "turn the wrench," but they will have greater abilities to interact with technology. The automobile will become far too complex for a technician to master predominantly with long years of apprenticeship, as in the past. Instead, they will use sophisticated electronic tools to diagnose problems and guide their repair and maintenance procedures. Traits such as problem solving skills, data analysis, and electronics understanding will become even more important, while accumulated experience will become less critical. This also implies a stronger background in math, science, and electronics as a foundation for being successful.

The industry is going through an adjustment period with the retirement of many experienced master mechanics and a supply lag in the kinds of skill sets needed to diagnose and repair modern vehicles. Fortunately, the transition will happen gradually, because the PARC evolves slowly. Also, technology will help address the skills gap, but it will be important for the industry and vocational schools to do more to ensure they attract, educate, train, and retain talented professional technicians.

Today, individual technicians make the actual part choice as often as the shop owner or designated purchaser in the shop. In the future, the individual technicians will become less likely to make the brand decision, with shops getting bigger and the brand choice becoming more important to consumers. (*Refer to pages 25-26*)

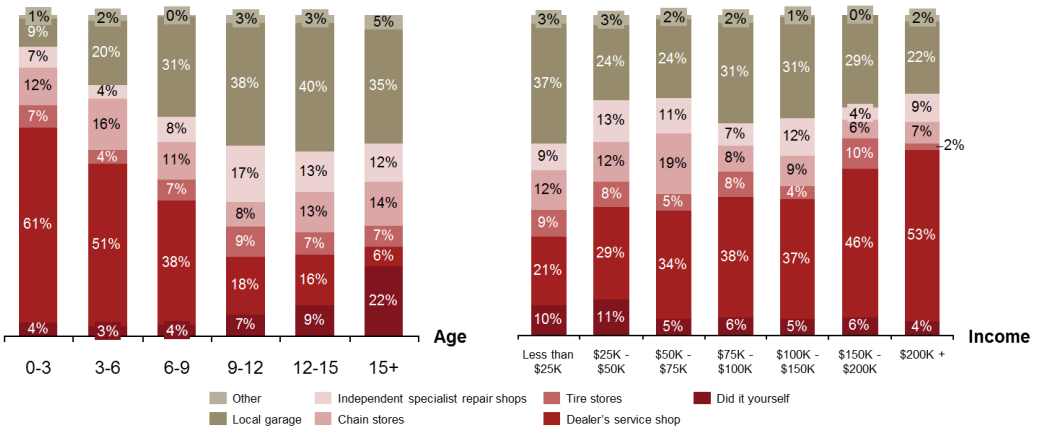
III. DIY and DIFM

The DIY market, particularly for more complex parts, has been dropping slowly for some time. Increasing vehicle complexity, an aging population, changing consumer attitudes about automobiles, and economic growth contribute to the volume decline. In addition, e-commerce and online information are pressuring the prices for DIY as well as DIFM parts.

> ***"Even a battery, due to its location or system complexity, is no longer something that anyone can replace."***
> *–Supplier*

As would be expected, our survey of motorists confirms that age of the vehicle, along with income, influence DIY penetration (*Exhibit 1*).

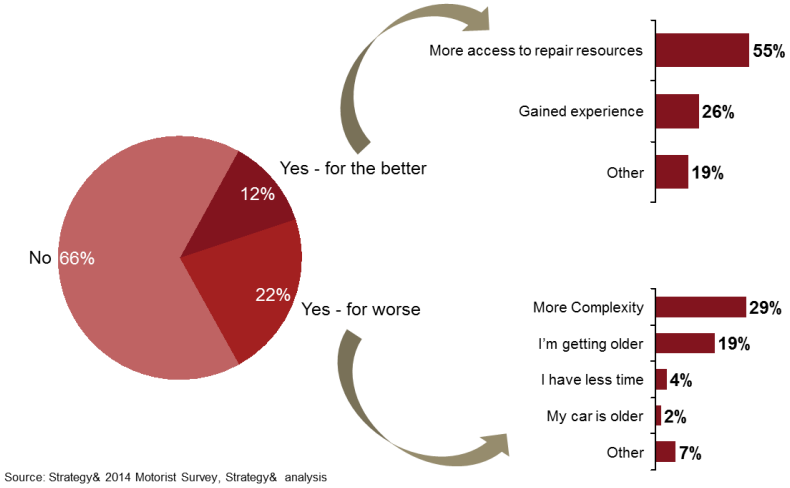
Exhibit 1
Which of the following outlets did you use the last time you needed vehicle repairs or replacement parts?



Source: Strategy& 2014 Motorist Survey, Strategy& analysis

It is interesting to note that two-thirds of owners do not believe their ability to work on their own vehicles is declining, and 12% actually think their ability is improving. Of the 22% who state their ability is worsening, increasing vehicle complexity is the number one reason (*Exhibit 2*).

Exhibit 2
Has your ability to repair your vehicle on your own changed over time?



Source: Strategy& 2014 Motorist Survey, Strategy& analysis

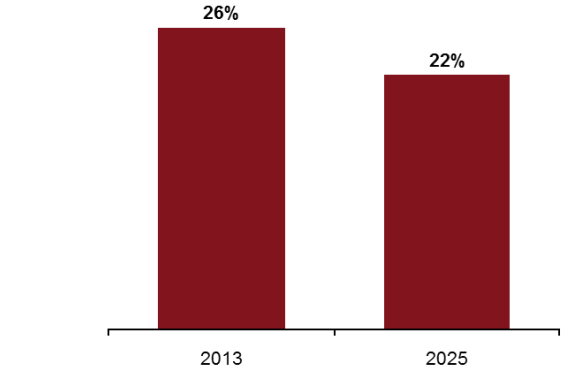
Several factors help sustain the DIY market. First, most people who work on their own vehicles do it for economic reasons. Many simply cannot afford to pay for someone else's labor and expensive parts. This will not change. In fact, with the widening income and wealth inequality in the U.S., there will continue to be a very large portion of the vehicle-owning population and PARC that relies on the cheaper option of DIY service. A second or third owner tends to be focused on having access to low-cost transportation, not maintaining the latest technological features in the vehicle unless mandatory. Also, with the large PARC in the U.S., there always remains a significant portion of basic maintenance and repair needed, and of older vehicles with mature technology. Finally, increasing data and information available online actually make repair information cheaper and easier to obtain over time, not less.

> ***"Complexity is hurting DIY, but many wear parts and service items still support a good DIY market."***
>
> *–Channel Partner*

While we estimate the overall U.S. light-vehicle aftermarket parts market[6] will grow at about 1.4% per year (*Exhibit 9*), the **DIY market will stay flat** in absolute terms. It will decline in both constant dollar terms and as a portion of the overall market, dropping about one percentage point every three years – from 26% in 2013 to 22% in 2025 (*Exhibit 3*).

The limited overall market growth will be in DIFM. Economic necessity, the continued need for basic maintenance, improving online repair information, and the large percentage of older vehicles in the PARC will help sustain the substantial DIY market.

Exhibit 3
DIY Shares in Automotive Parts Aftermarket (% of parts aftermarket)



	2013	2025
DIY Market Size:	**$20B**	**$20B**
Parts Market Size:	**$76B**	**$90B**

Source: AASA, Strategy& analysis

> ***"DIY is declining and commercial increasing. Europe is 90-95% DIFM. The U.S. will follow."***
>
> *–Supplier*

[6] The U.S. light-vehicle aftermarket parts market is defined as the final sales amount for all manufactured and remanufactured parts not used in the assembly of new vehicles. We exclude warranty, oil, tires, collision and body work, OTC telematics, tools, and equipment. Labor is not included.

IV. Future DIFM Market Structure

The most important customers for the majority of automotive aftermarket suppliers are the independent repair shops and their professional technicians. They represent $43B or 57% of the U.S. light-vehicle aftermarket parts market. This portion of the market is forecasted to grow to $52B or 58% by 2025; the new-vehicle-dealer portion of the DIFM market was $13B or 17% in 2013, growing to 20% in 2025 (*Exhibit 4a, 4b*). Warranty parts, another $7B in 2013, are not considered here. The combined (dealer plus non-dealer) DIFM portion of the U.S. light vehicle aftermarket parts market will be 78% in 2025.

Exhibit 4a
2013 Aftermarket Parts Size and Share by Segment: $76B

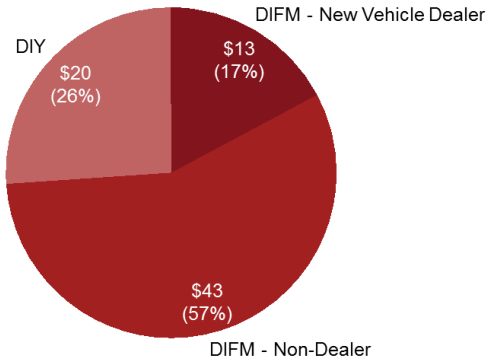
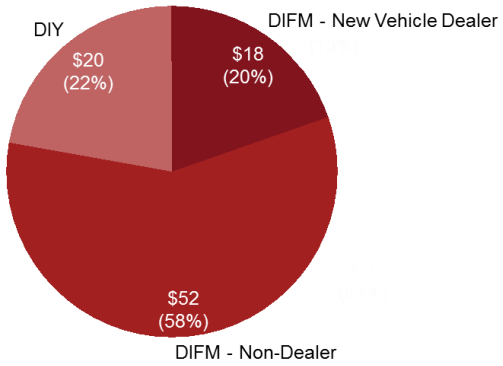


Exhibit 4b
2025 Aftermarket Parts Size and Share by Segment: $90B



Source: Strategy& analysis

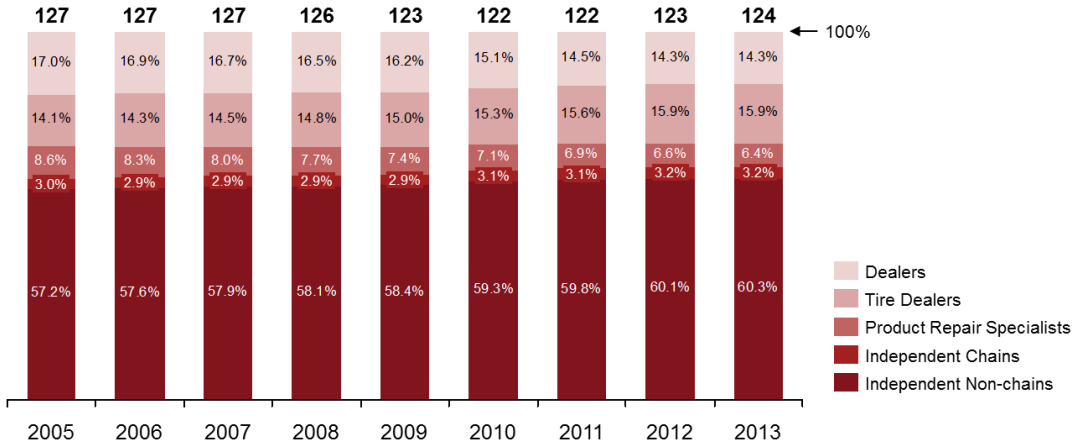
In the following discussion, we consider four types of DIFM outlets in addition to dealers (*Exhibit 5*).

Exhibit 5
DIFM Outlet Definitions

DIFM Outlet	Definition	Examples
Independent Chains	Establishment with 50+ locations (regional or national) engaged in providing a wide range of mechanical, engine, and electrical replacement, repair, and maintenance services for automotive vehicles	• Pep-Boys • Meineke
Independent Non-chains	Establishments engaged in providing a wide range of mechanical, engine, and electrical replacement, repair, and maintenance services for automotive vehicles	• Simon's Auto Services • Detroit Auto Clinic • Local independent repair shops
Repair Specialists	Establishments engaged in replacing or repairing specific automotive systems such as exhaust, transmissions, etc.	• Cleveland Transmission • Velasquez Mufflers
Tire Dealers	Establishments primarily engaged in retailing new tires but also provide automotive repair services	• Mavis • Goodyear

There are approximately 106,000 of these independent and specialty DIFM outlets and another 17,665 dealer outlets. The number of non-dealer outlets grew by about 2,600 or almost 3% in the past 3 years (*Exhibit 6*).

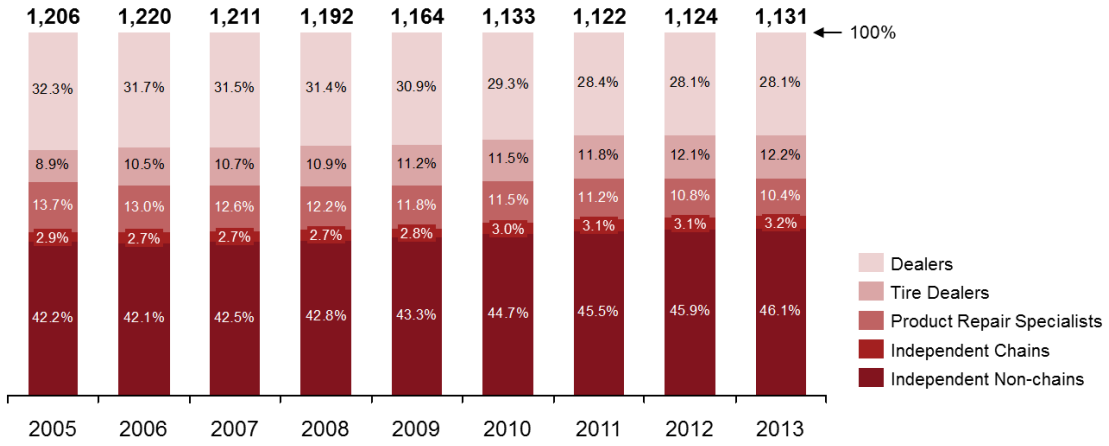
Exhibit 6
DIFM Outlet Share by Channel ('000s)



Source: Census Bureau, NADA, Strategy& analysis
Note: Does not include oil change/lube and body collision shops

These outlets have approximately 1.1 million bays in total today. Dealers have about 318,000 bays or 28% of the bays across all DIFM outlets. Overall the total number of bays has decreased, primarily driven by the reduction in the number of dealer bays since 2009. There has been a slight increase in the number of bays held by tire dealers and independents (*Exhibit 7*).

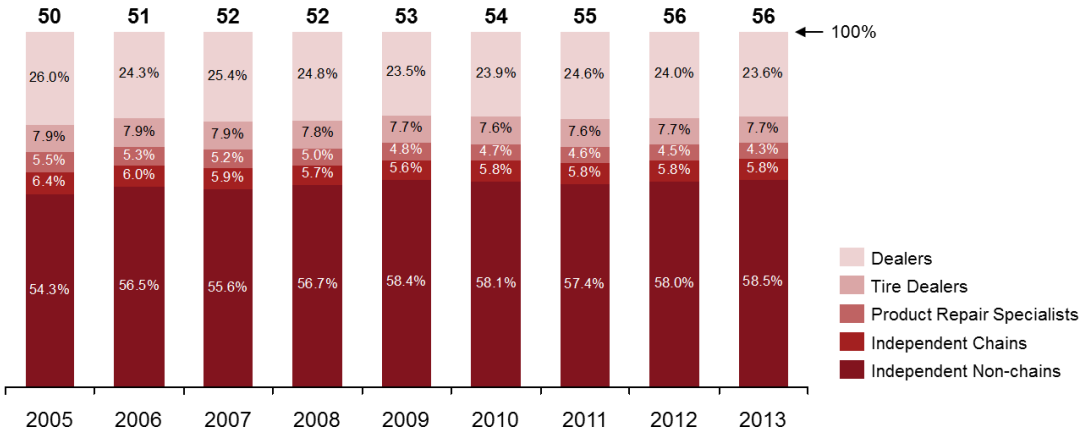
Exhibit 7
DIFM Number of Service Bays by Outlet Type ('000s)



Source: Census Bureau, NADA, Strategy& analysis
Note: Does not include oil change/lube and body collision shops

The breakdown of the U.S. non-warranty aftermarket parts business share by outlet type is as follows (*Exhibit 8*). Note that the total below does not include DIY which was another $20B in 2013.

Exhibit 8
DIFM Revenue Share By Outlet Type ($B)



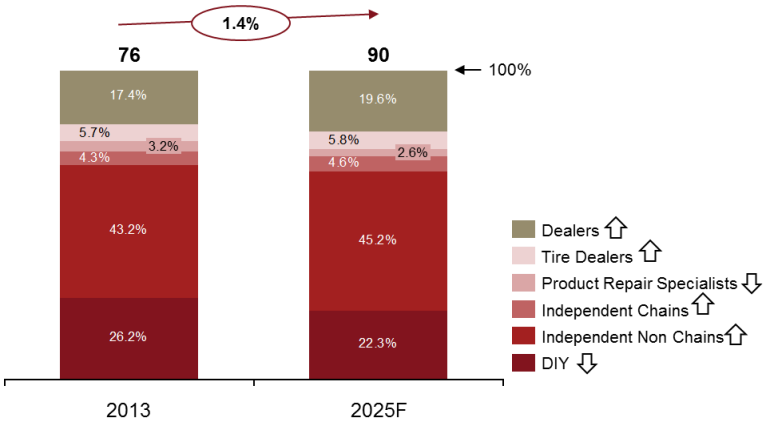
Source: Census Bureau, Strategy& analysis
Note: Does not include oil change/lube and body collision shops; Does not include DIY which is ~$20B

Speculation about the upcoming shape of the DIFM industry ranges from decimation of the independents to status quo. Undoubtedly the biggest concern about the future of DIFM is how the non-dealer outlets will fare against dealers in the fight for service share. Discussions with independent shops indicate that even they see their biggest competitive pressure coming from dealers, not other independents or aftermarket chains. There are plenty of reasons why many people believe the dealers will gain ground, some valid and some not.

In our view **the conclusion is clear that dealers will take some share, but it will be bounded**. From 2013 to 2025, we expect the dealers will increase aftermarket parts share from 17% to 20% (*Exhibit 9*).

Independent chains will grow from 4% to 5% of the aftermarket parts market. Independent non-chains will grow their share from 43% to 45% of the total aftermarket parts market.

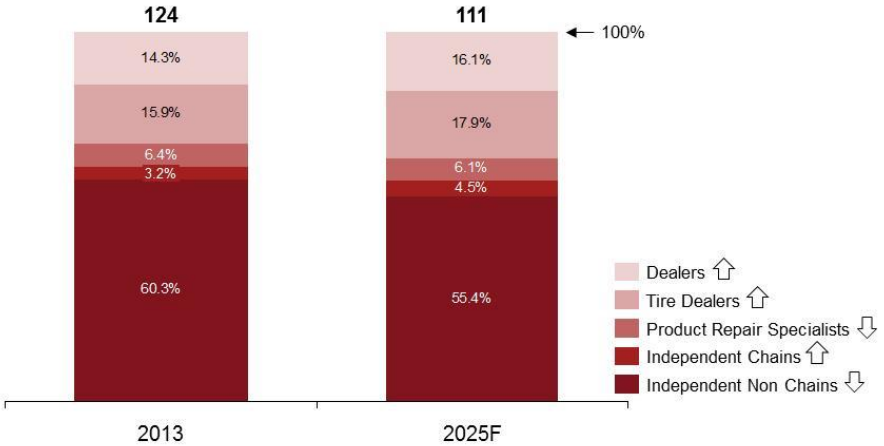
Exhibit 9
DIFM Revenue Share Forecast By Outlet Type ($B)



Source: Census Bureau, Strategy& analysis

In addition, we expect **very little growth of non-dealer chains or businesses with multiple outlets**. However, independent non-chain shops which are sub-scale and not able to make the necessary investments in technician skills, technology, shop appearance, and marketing capabilities required for the future, will not survive, and their share will be absorbed by other stronger outlets (*Exhibit 10*).

Exhibit 10
DIFM Outlet Share Forecast ('000s)



Source: Census Bureau, NADA, Strategy& analysis

What are the most important drivers of the change for the DIFM industry structure?

The five most important considerations in objectively assessing the future structure of the non-dealer DIFM network are: **1. OEM service strategies, 2. Dealer service strategies, 3. Advancing vehicle technology, 4. Telematics, and 5. Consolidation** (or more appropriately, the lack thereof).

1. OEM service strategies: **OEMs are increasingly focused on growing aftermarket service**, but their objectives and ambitions are not always obvious. They are different from each other, and they are very large, complex organizations with disconnected goals, perspectives, and initiatives across their various internal functions. For instance, a purchasing manager might try to prevent suppliers from selling similar products to competitors with restrictive intellectual property clauses in a contract. This person would have very little concern about the same OEM's sales organization trying to improve customer retention, much less about the OEM's aftermarket parts organization trying to market its branded parts through new-vehicle dealers as well as independent channels. **OEMs are not monolithic organizations with concerted plans to eliminate the independent aftermarket, as some fear**.

Nonetheless, at the top of most OEMs' objectives are selling more vehicles. As the U.S. vehicle market is slow growing over the long term, the battle for share is critical. Accordingly, the focus on customer retention has been getting more intense over time. OEMs and their dealers have learned they have a much better chance of keeping existing customers and attracting new ones if they provide great service. Thus, **several OEMs in conjunction with dealers have been working hard to improve and expand their service business**. They are aggressively pushing new technology (online offerings, in-dealer mobile digital tools, and

IT systems), data and analytics capabilities, processes, and training to help dealers make consumers' end-to-end service experience much more appealing, convenient, efficient…and competitive with the aftermarket.

They have been investing heavily in programs such as tire replacement, oil changes, and all-makes service. For example, Ford now has over 800 Quick Lane operations run by their dealers, primarily selling oil changes and tires. The motivation is not the meager margins from these services but rather the potential to sell more profitable services and, most importantly, more vehicles per store. The proposition is apparently working, as Ford has continued to invest in helping dealers expand this business.

While OEMs will bias more service business in favor of dealers than in the past, their efforts and results will be inescapably constrained. **In the end they will not be able to lock out the independent aftermarket because of legal limitations, brand protection, and practical concerns**. As with the Right to Repair battle, it is improbable they will prevail in any behavior that is aggressively anti-competitive. That does not mean the industry can be complacent; it must continue to push the OEMs to maintain fair practices with respect to the independent service market. Extreme actions that limit vehicle owners from accessing independent providers for lower price and better convenience would ultimately harm an OEM's brand – something they cannot abide. Additionally, since new-vehicle dealers cannot possibly absorb all the aftermarket service demand, attempts to shift significant share speedily are not reasonable.

2. Dealer Service Strategies: Dealers will increasingly look to service and parts to bolster their financials. Just like OEMs, some dealers have become more enlightened about the customer retention benefits of improved and expanded service operations. In addition, in the Great Recession dealers had to depend much more on service and parts to survive. Since that time, the robust rebound in new vehicle sales has greatly improved their profits, and more recently a burst of recalls has helped fill their service bays. So far these positive factors have more than made up for severe compression in new vehicle margins and the more recent softening of used vehicle margins. Going forward, dealers will have to depend more on parts and service business to earn healthy returns, since margin compression will not subside. It will persist due to intensifying intra-brand competition (due to internet-based price transparency and wider shopping areas) and inter-brand competition (due to the continued growth of great product offerings). The economics of new vehicle sales have been fundamentally altered, and the recent high growth cannot continue. Dealers will inevitably shift more attention and investment to service and parts. Many are already doing so.

While dealers will have some success, powerful factors will constrain the share shift **–** most notable are **bay capacity, price, and convenience**.

With 318,000 bays collectively, dealers represent about 28% of the **bay capacity** in the country. Much of the capacity must be used for warranty work, extended warranties, "included" maintenance plans, and recalls and campaigns. Customer-paid service has to be accommodated with the remaining capacity. Few dealers are adding brick and mortar for new bays. They are working to improve throughput and, in some cases, extending service hours. But the incremental capacity will only go so far. With high real estate costs often combined with limited expansion space and an inherent bias to the vehicle sales business, dealers can and will only expand service so much.

> ***"Dealers are working longer hours and improving efficiency in lieu of adding bays."***
> *–OEM*

Going forward, we expect the dealer bays to increase to 322,943 by 2025, an increase of ~5,000 bays, or less than 2%, over 2013 (*Exhibit 11*). **We estimate that dealers will capture an additional $4B of the aftermarket parts market by 2025 (a share increase of three percentage points over 2013**).

> ***"At the end of the day, dealers will have to compete for service on the basics – price, convenience, customer service, and marketing."***
> *–New-Vehicle Dealer*

Exhibit 11
Dealer Bay Forecasts

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2025F
Dealers locations	21,640	21,495	21,200	20,770	20,010	18,460	17,700	17,540	17,665	**17,941**
Average # of bays	18	18	18	18	18	18	18	18	18	**18**
Dealers Bays	389,520	386,910	381,600	373,860	360,180	332,280	318,600	315,720	317,970	**322,943**

Source: Census Bureau, NADA, Strategy& analysis

Dealers have historically had higher aftermarket prices than non-dealers. Their costs (labor, facility, and overhead) and margin expectations have prevented them from competing aggressively on price for most of the business in the past. A recent Consumer Reports survey of 120,000 motorists illustrates this point (*Exhibit 12*). Given that about 70% of the aftermarket is for older vehicles with the second or third owners, cost is a paramount consideration for much of the market. This will only become more pronounced in the future, as the PARC average age advances and income inequality increases in the U.S. (*Exhibit 13*).

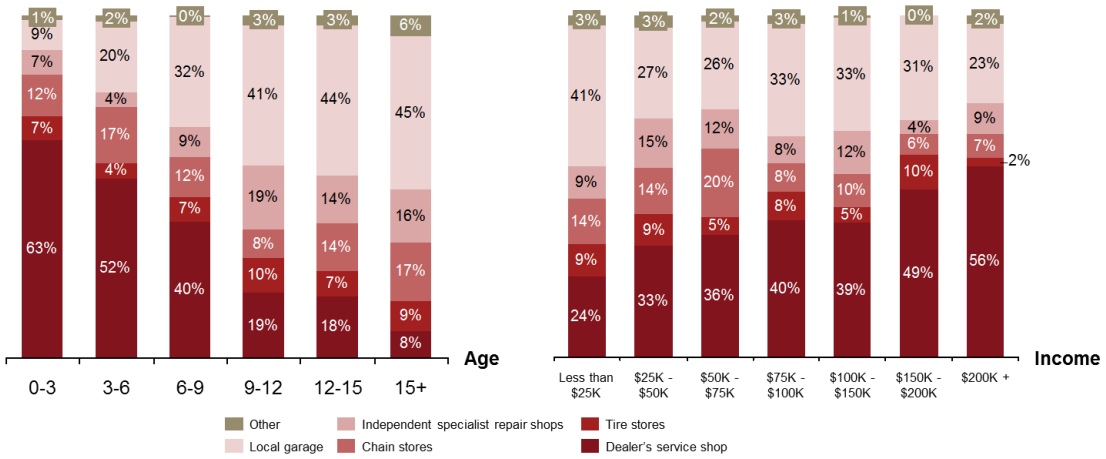
Exhibit 12
DIFM – Car Dealers versus Independent Shop Performance

Composite Score		Quality		Price		Timeliness		Courtesy	
Dealers	Ind. Shops	Dealers	Ind. Shops	Dealers	Ind. Shops	Dealers	Ind. Shops	Dealers	Ind. Shops
81	**88**	◑	◑	◔	◕	◑	◕	●	●

Source: Consumer Reports March 2015, Survey of 120k motorists

Lower ○ Higher ●

Exhibit 13
DIFM Outlet Preference by Consumers



Source: Strategy& 2014 Motorist Survey, Strategy& analysis

With new-vehicle dealers' aspirations to build the service and parts side of their business, they are working to be competitive on price (improving operational efficiencies to reduce costs, leveraging technology, and offering motorists a choice of OES versus lower cost IAM parts), but, as a group, they will remain in the higher-price segment of the aftermarket.

Convenience is a critical purchase consideration in DIFM aftermarket service. With typically longer hours and many more outlets, the local garages will maintain an important upper hand on this dimension also.

Importantly, with the push for dealers to service older vehicles and all makes, OEMs are now, unlike in the past, encouraging dealers to offer less expensive alternatives to OES parts. **These dealers are accessing the traditional aftermarket, presenting an important growth market for suppliers.**

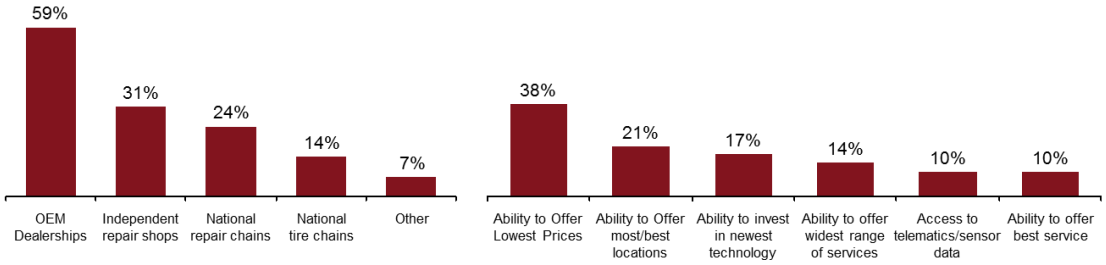
3. Advancing vehicle technology: Advanced technology ostensibly makes it quite difficult for independent shops to compete. Investments in diagnostic equipment, specialized tools and training needed to service more advanced vehicles, and the more technical jobs, will indeed put some pressure on independent shops to maintain competency. However, **good shops with sufficient scale and management skill will be able to keep up**. In actuality, diagnostic equipment and information are actually becoming cheaper and more accessible.

> ***"Affording the equipment is not going to be the problem. Small shops will struggle with the motivation and the education."***
> *–Independent Shop*

Our survey of shop owners indicates very few actually believe that more technology in vehicles hurts their businesses. While a majority of shop owners consider OEM dealers to be a competitive threat, this is driven largely due to price and location factors, not technology (*Exhibit 14*).

Exhibit 14

Who do you expect to be your biggest competitors in the next 5 to 10 years?



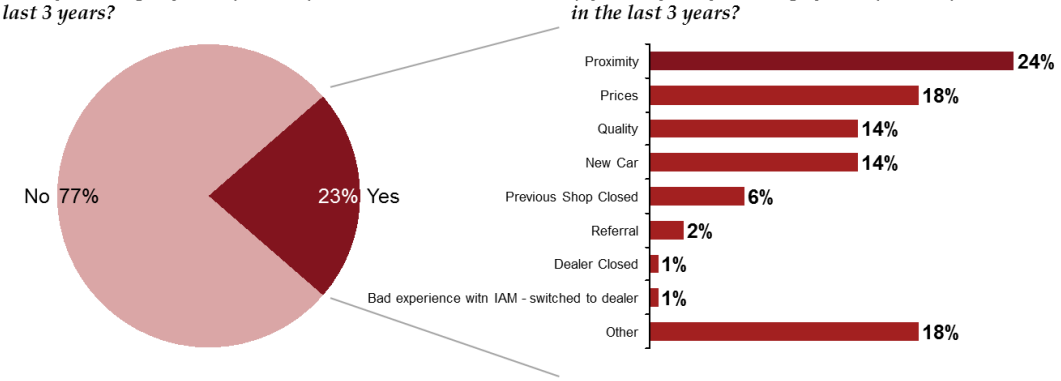
Source: Strategy& 2014 Professional Repair Shop Survey, Strategy& analysis

Some shops may need to specialize more (e.g., by type of repair or brand), some shops will not be able to handle the most difficult repairs, and some naturally will find it hard to survive. Still, even ten years from now, a large portion of the vehicles on the road will have older technology that the independent aftermarket can service today. Independent shops proved they can adapt to technological advancements in the past, and they should be able to do so in the future. In addition, customers are quite slow to switch their preferred service shops (only about 25% switch in a 3-year period), and when they do switch it is very rarely related to shop competency (*Exhibit 15*).

Exhibit 15

Have you changed your repair shop in the last 3 years?

If yes, why did you change your repair shop in the last 3 years?

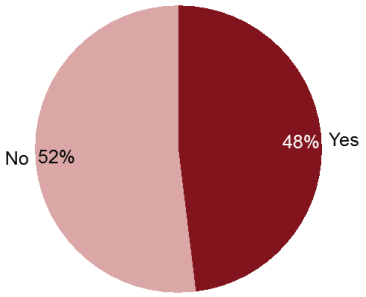


Source: Strategy& 2014 Motorist Survey, Strategy& analysis

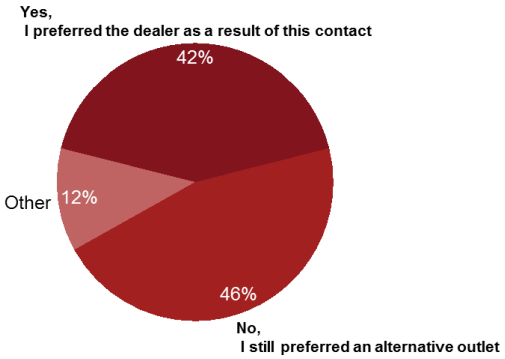
<u>4. Telematics:</u> Telematics may provide some advantage to dealers, but the impact on the non-dealer shops will be marginal. It is clear that when OEMs in concert with their dealers provide consumers, by mail or digitally, with specific, compelling information and offers related to needed repairs and maintenance, they gain advantage over the independent aftermarket (*Exhibit 16*).

Exhibit 16

Did you receive marketing material from your dealer regarding repair and service related issues on your vehicle in the past 12 months?



Did this change your preference in vehicle repair?



Source: Strategy& 2014 Motorist Survey, Strategy& analysis

Still, the primary way consumers are notified of required service is an in-vehicle indicator, which motivates the owner to go to his or her preferred shop. More often than not, that shop is a non-dealer. Also, it will be quite some time before most OEMs and their dealers have integrated telematics and customer relationship management (CRM) systems that cover a large portion of the PARC and proactively contact consumers about repair and maintenance.

> ***"Everyone thinks there is something secret here and it is a big deal. The reality is that it can all be done via a scan tool at an independent garage today. It's just about marketing to the customer."***
>
> *–OEM*

Actually, aftermarket options already exist that allow consumers to tap into some on-board diagnostic information about needed maintenance and repairs. Individuals then make their own choice about who will provide the service, just as in the past.

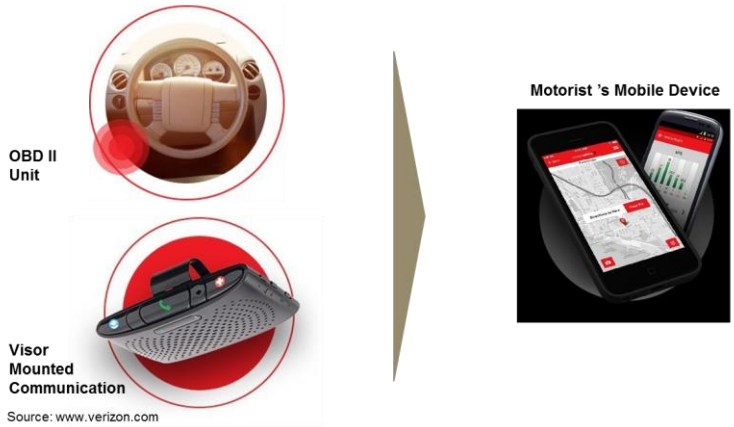
> ***"The entire aftermarket will benefit from telematics."***
>
> *–Channel Partner*

For example, Verizon's new aftermarket telematics offering (**Verizon Vehicle**) is about to hit the market. It provides a wide range of features, including the following.

- **Safety and security** – GPS-directed roadside assistance, automatic crash notification, emergency calling, and stolen vehicle location assistance
- **Maintenance and repair** – maintenance and service reminders, vehicle monitoring and diagnostic alerts, emissions status, recall information, and a mechanics hotline with A.S.E. certified professionals offering repair suggestions and cost estimates
- Other – parking management, travel and repair discounts

The potential range of services goes well beyond this list. The solution consists of a plug-in device for the OBD II port and a small visor-hung communications module (*Exhibit 17*).

Exhibit 17
Verizon Vehicle Example



At $15 per month, including hardware, the functionality is considerable. The costs and features will undoubtedly improve over time. Alternatives that leverage an owner's mobile device for communications instead of a separate module can provide much of this utility at a much lower price today and the costs will surely decrease over time, making the technology practical for the aftermarket service providers. **Effective adoption and integration of telematics by the aftermarket will be a considerably bigger challenge** than access to advanced technology and information, which should be obtainable and inexpensive.

More important than telematics is the marketing prowess to provide consumers with compelling service offerings, even if not predicated on knowing exactly when and what service is needed. This marketing capability is currently possible, but only some new-vehicle dealers leverage it fully, and even fewer independent service providers use it at all.

5. Consolidation: The final consideration for DIFM market structure change is **consolidation**. **The vast majority of independent, non-chain shops are single locations today, as has been the case since the beginning of the non-dealer aftermarket**. Few costs can be shared across multiple facilities, and other economies of scale are illusive. Only exceptional shop owners with strong business skills can leverage managerial and marketing knowhow among several locations. The fundamental economics of business are not changing in any major way. New investments in diagnostic equipment and specialized tools cannot be spread over different facilities.

As owners retire or leave the business, their businesses are very rarely bought by competitors. Again, they have little of value that can be transferred to other outlets. Only their physical locations sometimes have value. Instead, most often other surrounding DIFM outlets pick up share when business ceases to exist, or occasionally someone takes over the existing single-location operation. Weaker shops will go out of business, but few will be acquired.

> ***"Consolidation is not going to be big. There are so many independent shops, and a lot of the great ones are small."***
> *–Supplier*

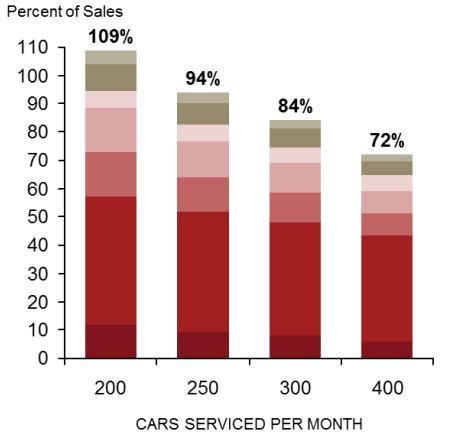
Additionally, although chains have gained some share, they still only represent about 4% of the parts aftermarket today (5% of the non-dealer market). We expect this slow share growth to continue in the future. To date no chain has gained such an advantage that they have been able to consolidate aftermarket shops, as has been the case in other sectors where large stores, purchasing power, or other economies of scale have allowed large players to push aside most of their smaller competitors.

> ***"The market will stay fragmented. We're really only thinking about 1-2 points in share shift to chains."***
>
> *–Service Shop Chain*

These advantages don't apply to this industry, where local relationships and efficient selling of shop labor are most important. In addition, as seen below, scale benefits exist at the individual shop level rather than across multiple shops (*Exhibit 18*).

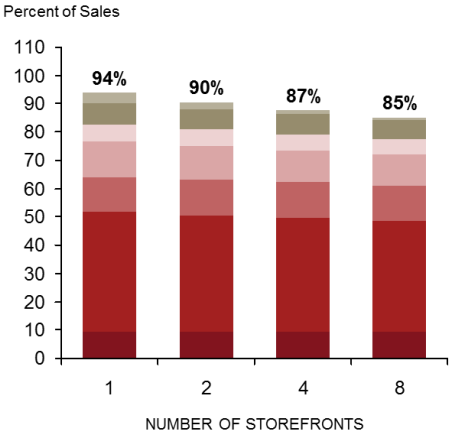
Exhibit 18

Impact of Cars Serviced on Shop Costs



Note: * Single storefront with 4-6 service bays and ~400 car per month max. throughput capacity per month

Impact of Number of Storefronts on Costs



Note: * Multiple 4-6 bay storefronts operating at 250 cars per month , ~60%,throughput capacity

Adv & Mktg. | Equipment Maintenance | Rent/Lease | Utilities & Misc.
Depreciation on capital equipment | Manager Salary | Salaries & Wages

Source: Field interviews, Strategy& analysis

Today, no chain brand stands out as being exceptionally strong in offering the broad array of maintenance and repair-related services to compete with dealers and full-service independents. With only a few large chains, even if they are as successful as they could imagine, at best they can only gain a point or two of market share each. This means that as a whole, the chains that will be around a decade from now are probably the ones that exist today and, **at most, chains will be able to gain 1-2 points of market share in the aggregate, still leaving most of the non-dealer market to single-location independents**.

Rather than consolidation, the DIFM market will have more specialization in 2025. Non-dealer shops already specialize to some extent today. Our research suggests that about 25% of shops don't handle the full suite of vehicle makes. Specialization of this or other types will inevitably increase in response to the investment in tools and training required to be

proficient at repairing increasingly complex vehicles. Another type of specialization, roving diagnostic specialists, exists today and will become more common.

Unlike many other industries where synergies accrue from consolidating operations across companies, the non-dealer repair shop business will continue to be quite fragmented. Some smaller shops without the business skills and investment capacity for tools and training will fade away. Their share will be easily absorbed by the broad range of other players in the market. We do expect to see more specialization among shops than today.

In summary of this section, the outlook for the DIFM market structure is not a lot different than today, but, as described in the next sections, how they operate will change quite a lot. In the battle for DIFM customers, while dealers have some important factors in their favor and will gain ground against non-dealers, they are expected to only take a few share points over the next 10 years or so. The fears of some that dealers will decimate the independents are overblown. Their gains will be narrow and slow, but not insignificant. The countervailing forces of limited dealer bay capacity, higher dealer prices, and lower convenience will combine, as they have in the past, to sustain most of the aftermarket in the non-dealer world.

> ***"OE dealers have an advantage. The question is will they capitalize on it? I don't think so. Mindset is their biggest limitation."***
>
> *–Supplier*

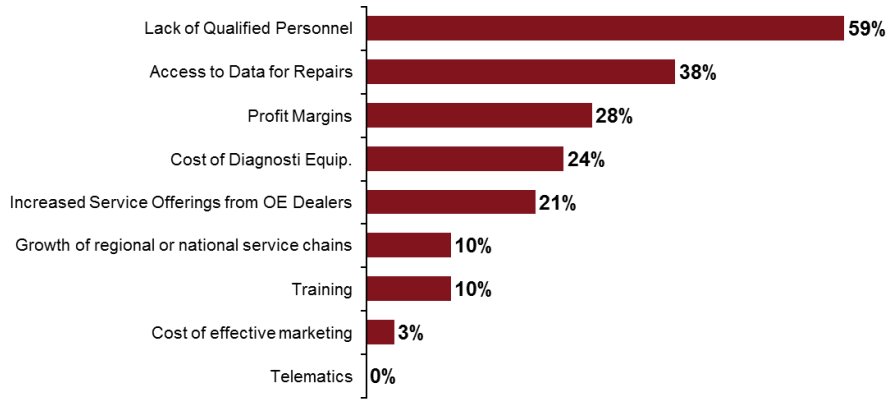
Winning service providers, dealers or non-dealers, will need to develop and utilize more advanced marketing to gain an edge. Today, dealers in general have superior marketing, but as these capabilities become more affordable and common, non-dealers can and should catch up. Some non-dealers will not adjust well to the market dynamics and will fade away. Other more capable ones will fill the void. Suppliers and channel partners have an important role to play in helping DIFM transition.

V. The Independent Shop of the Future

The successful independent DIFM shop in ten years will be very different from today. **Technology will reshape how vehicles are serviced as well as the entire customer experience.** Technology may be creating challenges for the DIFM world as vehicles become more complex, but at the same time technology will help with these challenges and make service better for both providers and consumers.

Technology will help resolve the top, forward-looking concerns of independent shops – insufficient, undertrained labor pool plus the availability and affordability of diagnostics information and equipment (*Exhibit 19*).

Exhibit 19
What are your top two biggest concerns over the next ten years?



Source: Strategy& 2014 Professional Repair Shop Survey, Strategy& analysis

The technician of the future will use electronic systems to access most of the information that the mechanics had to know in the past. Much more advanced diagnostic and service support devices will assist technicians in their work. The devices may be application-specific scan tools, smart mobile devices, or even wearables enabled by the same electronics revolution that is exponentially swelling the intelligence and features of vehicles. All indications are that equipment accessibility and costs will not be a constraint. In fact, diagnostic tools are actually getting cheaper while becoming ever more powerful.

Although this may make the job seem easier, it will require future technicians to be knowledgeable in different ways. The vehicle will be too complex for a technician to master as a whole, unlike in the past. The ability to "turn the wrench" will still exist, but the skills and abilities of the technician will be centered on their ability to interact with the technology. Other traits that computers cannot emulate, such as social intelligence, novel and adaptive thinking (responding to an issue without clear, written rules), computational thinking (knowing how to apply data and recognizing what data is relevant and what is not), will become important.

Younger, more electronically-oriented technicians with these skill sets will be able to perform complex work without requiring years of apprenticeship. The best will garner higher wages

and potentially specialize in certain repairs. The technology will partially offset the required higher wages by improving efficiency, quality, and speed of repairs and maintenance.

There is not one simple solution to the purported shortage of skilled technicians. It is important to understand that the shortage is not in the entry levels. Wage rates, course completions, and job hire rates all indicate there is sufficient supply of entry-level technicians (*Exhibit 20*).

Exhibit 20
Study Course Completions and Entry Job Postings

Occupation	Avg Monthly Postings (Jan 2014 – Apr 2015)	Avg Monthly Hires (Jan 2014 – Apr 2015)
Automotive Service Technicians and Mechanics	22,790	52,321
Program	**CIP Code**	**Completions (2013)**
Automobile/Automotive Mechanics technology/Technician	47.0604	39,003

Source: EMSI

> ***"Enrollment for automotive technicians is steady and placement is very strong."***
> *–Technical Institute Career Services*

The shortage appears to be in the ranks of more experienced master mechanics due to three broad reasons - workers retiring from the labor force, migration of experienced technicians to better paying jobs within and outside the auto sector such as aerospace, and the enhanced skill sets required to diagnose and repair modern automobiles.
As discussed earlier, the market will adjust as a more math and science savvy workforce enters the job market and fills the gaps. In the interim, aside from technology, several different changes will help – segmenting and segregating low-skill and high-skill repairs, leveraging training from a variety of sources, attracting young people to the industry, and providing better retention programs.

> ***"We really need to change the business model. We need to develop talent and pay our skilled techs better…They need to walk through the steps to diagnose a problem."***
> *–Independent Shop*

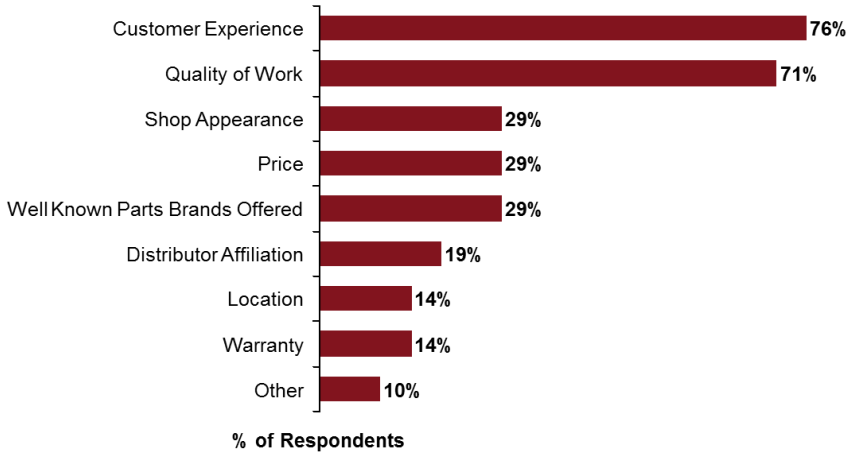
As with Right to Repair, it does not seem that OEMs will be able to, or will want to, prevent the non-dealer shops from accessing repair information, except possibly when safety is a major concern. Otherwise it is not in the long-term interest of OEMs to unduly prevent vehicle owners from cost-effectively getting their vehicles maintained and repaired, and anti-competitive actions are unlikely to prevail.

Additionally, technology will profoundly revamp how customers are served by independent shops. The best shops will offer **an impressive suite of digitally-enabled marketing and customer management capabilities** that rival those found in leading industries today.

> ***"Word of mouth is still good, but digital marketing is key."***
> *– Independent Shop*

Customer experience is what drives loyalty and differentiates good service providers from others (*Exhibit 21*).

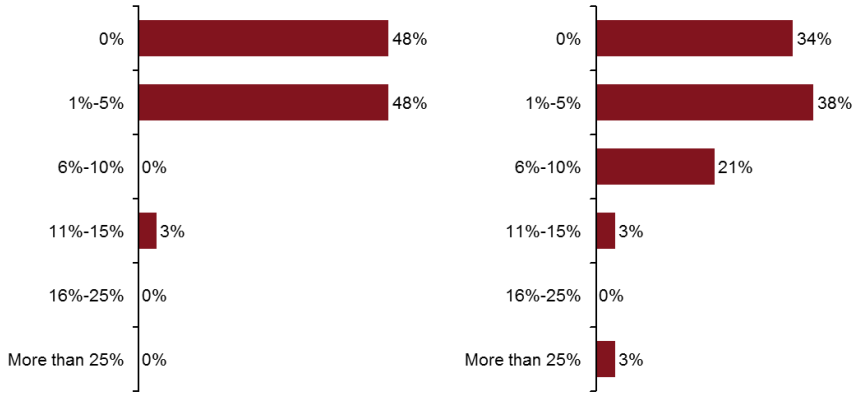
Exhibit 21
What are the reasons for your returning customers?



Source: Strategy& 2014 Professional Repair Shop Survey, Strategy& analysis
Note: Represents percentage of respondents who assigned a rank of 1,2 or 3 for each attribute. Rank scale runs from 1 to 9, from most important to least important

While digital technology will fundamentally change the independent shop of the future, e-tailing is not expected to make major inroads. In the DIFM segment only about half the shops buy from e-tailers, and those that do so only purchase a small portion of their volume online. They expect this to increase in the future but only by a small amount (*Exhibit 22*).

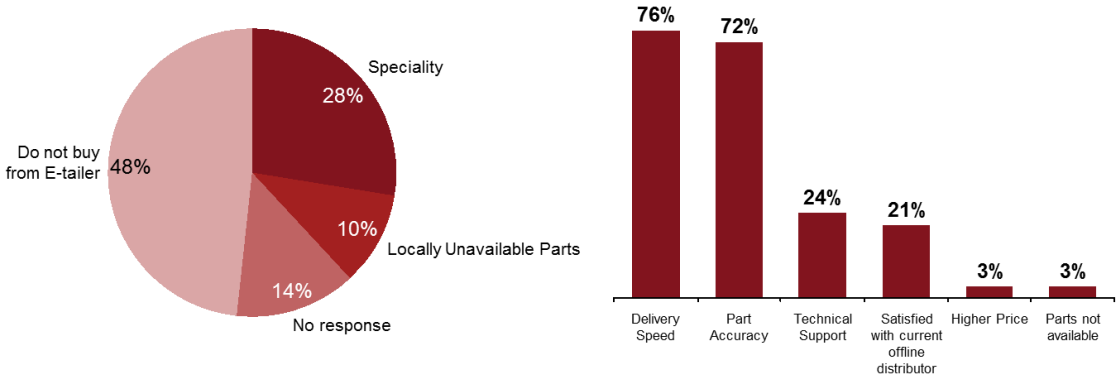
Exhibit 22
What percentage of your parts purchased today are through an e-tailer (e.g. Amazon, RockAuto, etc.)?
Five years from now, what percentage of your parts purchases are likely to be through an e-tailer?



Source: Strategy& 2014 Professional Repair Shop Survey, Strategy& analysis

DIFM shops that purchase on the internet tend to mostly use it for hard-to-find parts (specialty, older parts) that they cannot quickly source locally. The reasons they rely on local providers are the need for fast delivery, concern about receiving the wrong part they cannot easily return, and lack of technical assistance (*Exhibit 23*).

Exhibit 23
What kind of parts do you buy through an e-tailer?



Source: Strategy& 2014 Professional Repair Shop Survey, Strategy& analysis

Instead of generating substantial sales from independent shops, e-tailing serves to help them access hard-to-find parts. Information from e-tailers and other online providers is continuing to make consumers more informed about parts pricing and repairs in general.

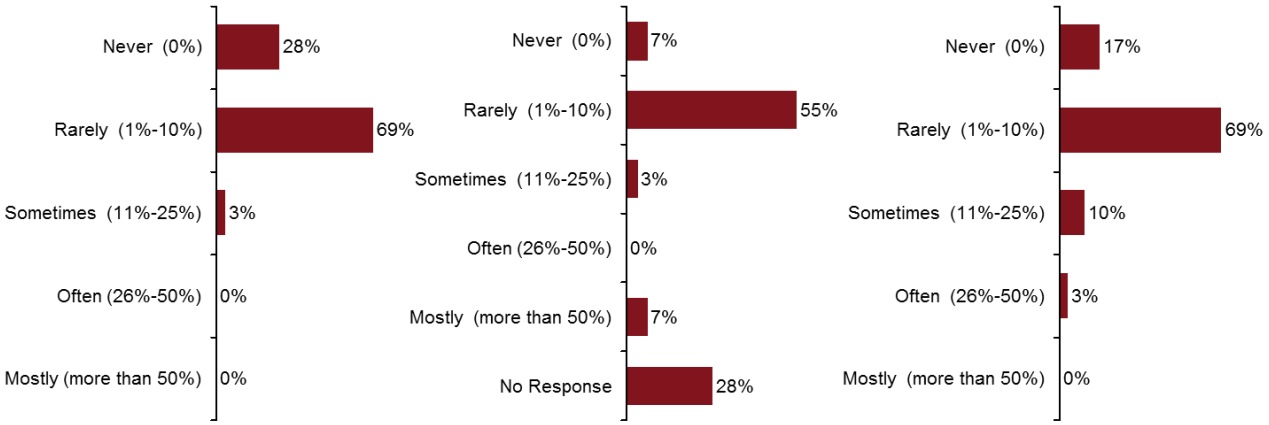
Some price-conscious DIFM customers do purchase their own parts and then attempt to have the independent shop install them. Our survey of shops indicates that this is still a fairly rare practice, and shops are loath to accept it. Nonetheless, shops do perform install-it-for-me service (IIFM) on occasion. However, just as they predict, **IIFM should not expand much in the future** (*Exhibit 24*). The potential for unsatisfied customers or even safety issues due to the wrong part, wrong repair, or a faulty part are just too great for shops to get comfortable with growing this type of business.

Exhibit 24

How often does your shop get customers who bring their own parts for you to install?

How often does your shop accept customers who bring their own parts for you to install?

Five years from now, how often do you expect to get customers who bring their own parts for you to install?



Source: Strategy& 2014 Professional Repair Shop Survey, Strategy& analysis

As parts prices become more transparent to vehicle owners, shops are more likely to shift more of the mark-up to labor in order to reflect the true economics of business. Shops will have no choice but make more of their margin on selling labor, their real differentiation, and less on selling parts. Customers will have no choice either. Shops need to charge a reasonable price to stay in business and serve their customers; simply cutting the parts mark-ups without an offsetting increase in labor rates is not a feasible solution and is not sustainable. Managing this shift in business practices and customers' expectations will require clear marketing and communication from the industry.

In summary of this section, DIFM shops must work on improving their competitive basics while building capabilities to harness the technology advances in diagnostics and repair, marketing, and shop management. Embracing technology can assist the transition to servicing more complex vehicles. It can also ease the challenge of attracting, training, and utilizing competent service technicians, as well as improve shop processes and administration.

> ***"We've got guys who look like they just crawled out of the woods and then want to work on your car – we need to create a more professional environment, so we can charge more and make customers see the value."***
>
> *–Independent Shop*

Perhaps most importantly, DIFM shops will need better capabilities to meet the expanded service expectations of consumers and to combat the competitive threat from dealers. Independent DIFM shops will need to invest in customer relationship management, digital marketing, better facilities, customer handling training, improved processes, etc. They must raise their game on several fronts to compete successfully in the new world, and they will benefit from help from suppliers and channel partners to make the transition.

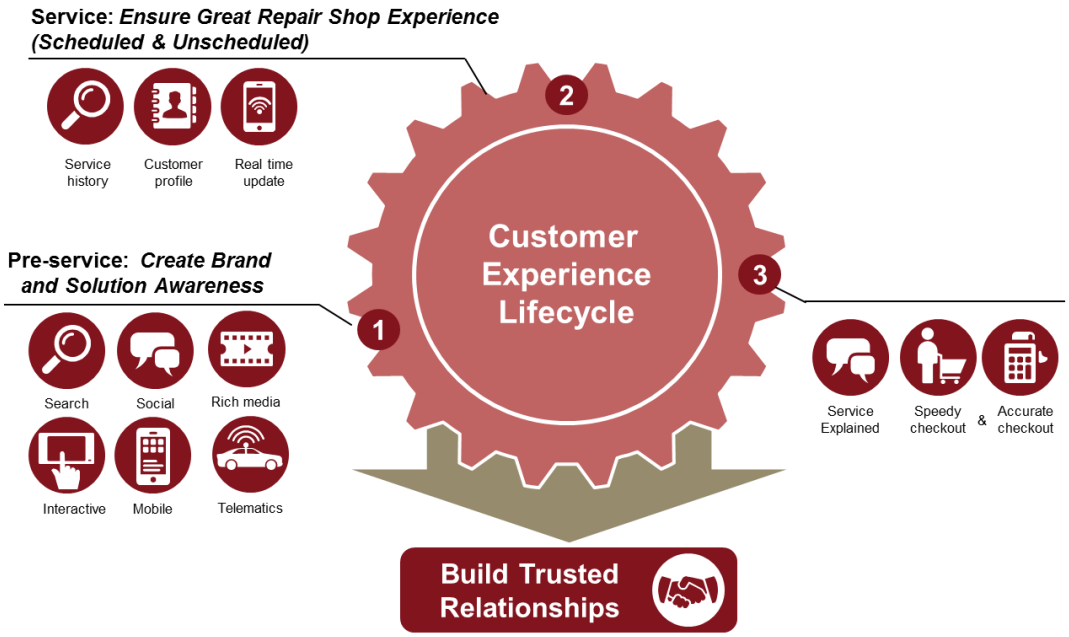
VI. Evolving Customer Expectations

The successful DIFM independent shop of the future has no choice but to respond to expanding customer expectations. **Consumers are influenced by their experiences from other industries** and services. Aside from a few exceptional independents and leading dealers, **the customer experience in most DIFM environments is poor by comparison**. Cost and functionality improvements driven by digital technology are compounding according to Moore's law and are continuously elevating customers' experiences, making them more timely, hassle-free, transparent, personal, flexible, and effective. Impressive capabilities are becoming affordable and attainable quicker than ever. The offerings that are just now coming available in the most progressive service industries will be commonplace in the aftermarket in 2025.

End customers' expectations are greater than what the aftermarket offers across the board, including pre-service (marketing, shopping, scheduling, customer greeting, and transportation assistance), service (customer handling, pricing, facility quality, and communication), and post-service (settlement, vehicle condition, and problem resolution).

The following provide some examples of what consumers will come to expect from DIFM shops (*Exhibit 25*):

Exhibit 25



Pre-service: Personalized digital marketing and promotional offers, potentially based on shop-provided or sponsored telematics; shop-provided educational information and videos; access to extensive reviews and social media information about the shop; online scheduling, possibly including technician selection; initial diagnostics, potentially based on shop-provided or independent telematics; online parts pricing, and possibly selection, information.

Service: Personalized greeting by employee equipped with mobile device that has customer information and history, quickly diagnoses problems, specifies service requirements, estimates costs, provides parts selection options and pricing comparisons, and approximates completion timing; immediate and paperless service write-up; modern and inviting waiting area akin to that found in the best dealerships today; free or discounted electronic coupons for transportation on Uber, Lyft or other local service; online updates about the service operation as it takes place and about estimated completion timing.

Post-service: Speedy checkout with thorough explanation of services performed and costs, provided electronically and/or on paper; multiple options for submitting customer satisfaction feedback and reviews; loyalty program offers and updates; multiple modes for follow-up questions or issue resolution.

As the internet provides more information and consumers become more digitally involved in vehicle service, the role of brands is changing. Previously supplier brands were mostly developed with the shop or technician in mind. As consumers go online as their first stop in searching, selecting, or just scheduling aftermarket service, they are much more readily exposed to parts brands, even if they are DIFM customers.

Brands that have a strong online presence geared toward the consumer are faring much better than those that don't. Consumers are influenced by what they see online, from a variety of sources. Strong supplier brands that were built over a very long time, for the trade, can quickly be diminished in the consumers' eyes due to weak information, biased information (e.g., bad reviews), misinformation, or even disinformation. In contrast, suppliers who actively manage their brands online can benefit from end-customer pull like never before, and it can happen in a few years as opposed to decades. **Suppliers can and should work to build brand equity with DIFM consumers and DIFM professionals.**

In summary of this section, customers increasingly expect more technologically-rich and modern experiences when having a vehicle serviced, and the DIFM market has no choice but to respond. Every part of the industry will need to adapt.

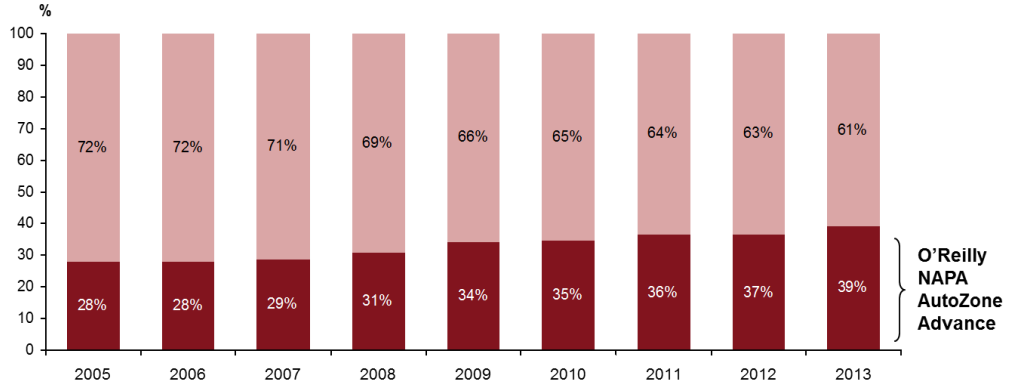
VI. Distribution Change Impacting DIFM Battleground

One of the most dramatic changes in the industry has been in the channel, and this is expected to continue to be the case. Channel consolidation has been the chief dynamic in the industry for some time now.

> ***"Suppliers used to have all of the leverage (1980s); now the distributors have the leverage."***
>
> *–Industry Expert*

As it has intensified, it has transformed the industry. Alone, the top four channel partners often referred to as the "Big 4," control about 40% of the market or 48% of the non-dealer market (*Exhibit 26)*

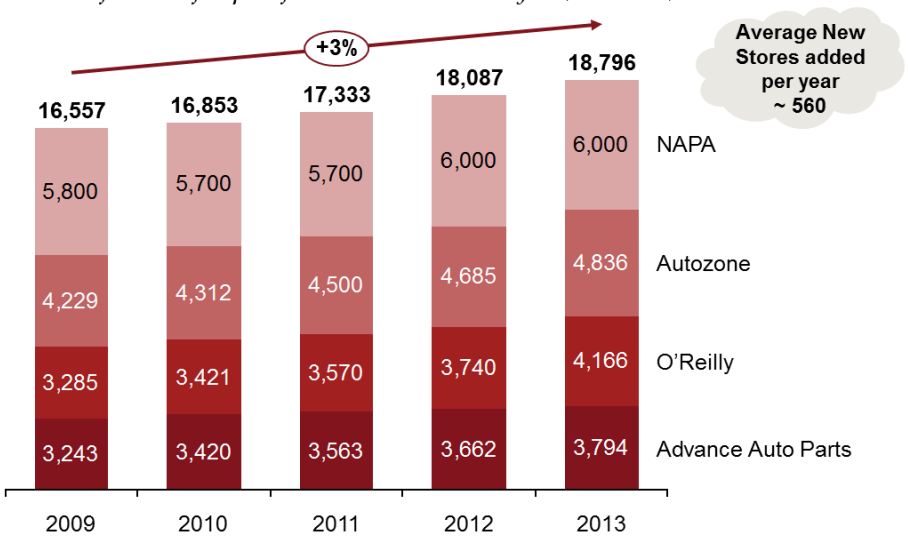
Exhibit 26
Market Share of Top 4 Aftermarket Channel Players 2005-2014
(% of Total Aftermarket Parts Market Excluding Labor)



Source: Company financials, Analyst reports, Strategy& analysis

While the total number of aftermarket channel outlets is not changing, big players have added stores at a rate of 400-500 per year (*Exhibit 27*).

Exhibit 27
Number of Stores of Top 4 Aftermarket Channel Players (2009-2013)



Source: Company 10-K reports and Strategy& analysis
NAPA's store count combines independently owned and company owned stores.

Today, the remainder of the market is mostly composed of program groups such as Pronto and Federated (*Exhibit 28*), supporting warehouse distributors (WDs). It is now hard to fathom a WD or jobber of any type not being part of a program group. **Further consolidation is assured**, possibly at the top and most certainly below. Smaller WDs will continue to lose share due to lack of sufficient scale and local competition.

> ***"The WD system will consolidate. A limited number of large regional players can compete with the Big 4 in their region."***
> *–Supplier*

Exhibit 28
Major Program Groups and WD Memberships

Program Group	# WD Members	#WD Locations	# Stores Serviced
Aftermarket Auto Parts Alliance	53	136	2000+
AIM	150	300	N/A
Automotive Distribution Network	100+	300+	2500+
Federated Auto Parts	66	155	4500
National PRONTO Assn	93	188	1500+

Source: Analyst reports and Strategy& analysis

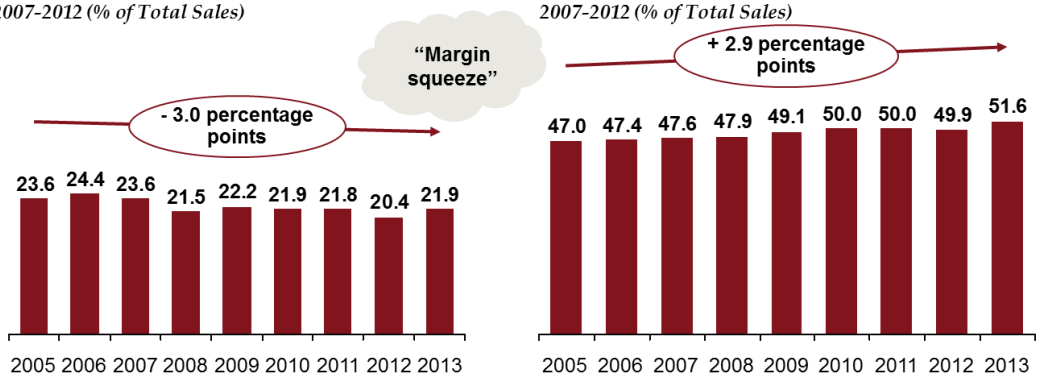
Suppliers inevitably will need to master serving large and ever more sophisticated channel players. Those who have not figured out how to work effectively with these partners have suffered for it. Channel players will become even bigger and more demanding, and those not in the top ranks will have to receive equivalent concessions from suppliers to compete with their larger rivals.

> ***"The bigger you are the more leverage you have. It's hard to be a small player in the aftermarket today."***
> *–OEM*

The pressures on suppliers from channel consolidation will only increase over time. The margin squeeze and extended terms that suppliers have experienced have enabled large channel players to reap hefty rewards (*Exhibits 29a-b, 30a-b*).

Exhibit 29a
Average Gross Margin of Selected Suppliers[1]
2007-2012 (% of Total Sales)

Exhibit 29b
Average Gross Margin of Top 3 Retailers[2]
2007-2012 (% of Total Sales)



1) Average of gross margins weighted by company sales; includes Global Aftermarket segment of Federal Mogul, Tenneco, Standard Motor Products, and Dorman.
2) Includes AutoZone, Advance Auto Parts, and O'Reilly. Average of gross margins weighted by company sales.
Source: Company financials; Analyst reports, CapitalQ, Strategy& analysis

Exhibit 30a
Average Return on Capital of Selected Suppliers
2006-2012
(% of Total Capital)[1]

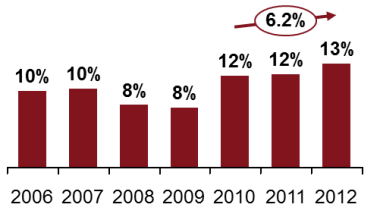
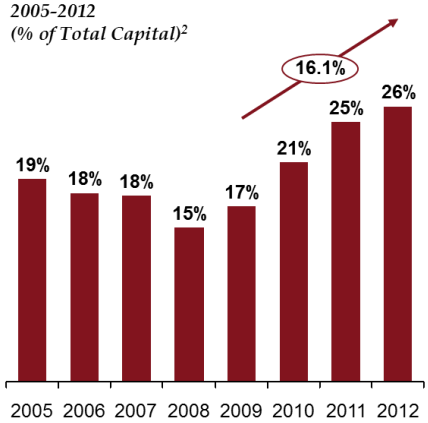


Exhibit 30b
Average Return on Capital of Top 3 Retailers
2005-2012
(% of Total Capital)[2]



1)Average of ROC weighted by company assets; includes Global Aftermarket segment of Federal Mogul, Tenneco, Standard Motor Products, and Dorman.
2)Includes AutoZone, Advance Auto Parts, and O'Reilly. Average of ROC weighted by company assets
Source: Company financials; Analyst reports, CapitalQ, Strategy& analysis

However, this game has largely played out among the top channel players. **The next phase in channel evolution is likely to see more intense competition among the goliaths and their competitors** rather than merely leveraging their power over suppliers. This does not mean relief for suppliers, only that the channel partners must find different new ways to keep delivering shareholder value growth. The winners will need to triumph over peers to prevail. The channel players are dealing with a variety of tall tasks that are somewhat tied together:

- Expanding into new segments
- Integrating acquisitions
- Updating business models for managing multi-segment operations
- Rationalizing and optimizing delivery models across very different demands
- Responding to e-tailing and its affects

As major channel players fight among themselves for share, **the distinction between retail (DIY) and commercial (DIFM) auto parts stores are fading.** Given the miserly market growth, most top players have to sell to DIY and DIFM customers, and the traditionally retail-oriented companies are making acquisitions and working to shift portions of their business to the commercial side (*Exhibit 31a-b*).

Exhibit 31a
DIY sales performance across major channel players

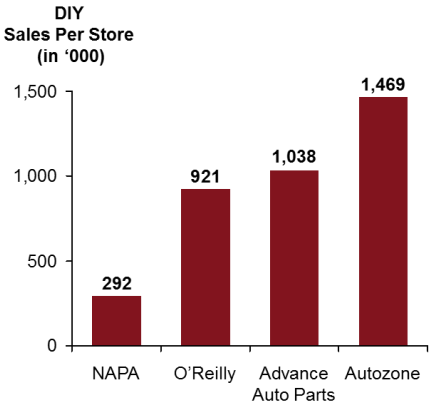
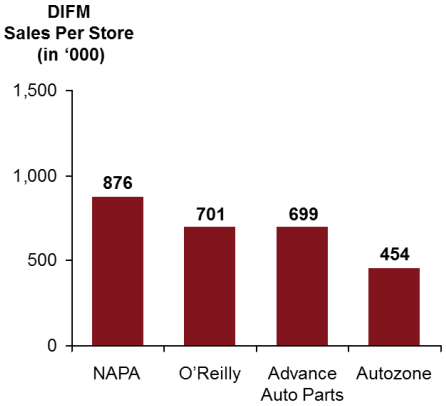


Exhibit 31b
DIFM sales performance across major channel players



Source: Analyst reports and Strategy& analysis

Several channel players have made acquisitions to accelerate moves into DIFM, imports, or other market segments (see below). Effectively **integrating major acquisitions requires exceptional effort and management attention**.

- In September 2014 AutoZone purchased Interamerican Motors, the second largest distributor of original equipment parts for imports. In December 2012 AutoZone purchased AutoAnything.com, an ecommerce leader in aftermarket automotive parts
- In 2013 Advance Auto Parts purchased General Parts Inc., including CARQUEST, CARQUEST Canada and WorldPac, for $2.04 billion

Aside from acquisition integration, all major **channel players need to invest in better supply chain systems and capabilities** to deal with the SKU proliferation, multiple product price points and brands, and the competitive imperative of better service levels. The aftermarket as a whole still has too much inventory - *an estimated $24.9 to $34.4 billion in the channel*. At the same time, fill rates to end customers are low compared to other industries.

"We will have to have even more inventory close to the customer to deal with SKU proliferation."
–Large Channel Partner

"SKU proliferation will continue, driven by the OEMs."
–Supplier

Trying to manage multiple business models (for DIY and DIFM) compounds the challenges for channel players. Ideally DIY and DIFM operations require differentiated product portfolios, brand strategies, support services, merchandising, forecasting, and supply chains. Developing and implementing capable mixed models will take a lot of time and resources. The most advanced companies in any industry find it difficult to manage multiple business models with one enterprise; the aftermarket channel players are sure to struggle with this challenge for a while.

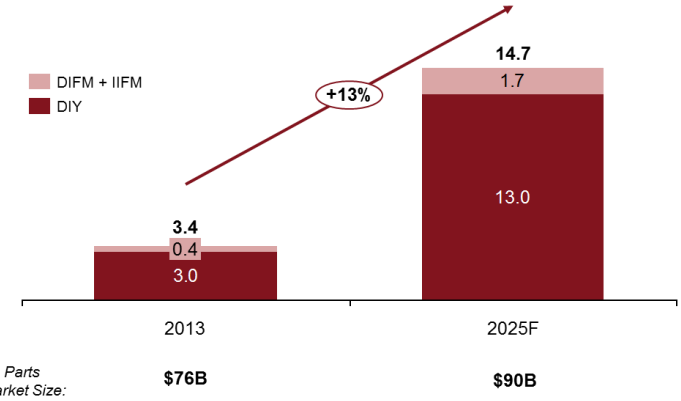
The supply chain challenges that channel players are dealing with go well beyond just serving DIY and DIFM at the same time. The number and types of "steps" and "stops" that aftermarket parts travel through in order to get to end customers are extremely complex and confusing…and they are evolving. It is no wonder that the industry does not have meaningful, common terminology to describe the different delivery models in play. It is tremendously difficult to optimize parts flows across the various degrees of freedom – different geographies, different types of parts, different types of facilities, different types of customers, and different service levels at different times. There are many different models in use today and typically within the same company. Most channel players have not aligned their costs and margins well across their current model variations. Just a few of the potential questions begin to illustrate the complications:

- How might a retailer or supplier price product that is drop-shipped by the manufacturer to a store, bypassing its local warehouse or hub store?
- How might a traditional WD, who has both independent jobbers and owned stores, manage margins across the network when some products bypass either the warehouse or the jobber/store on the way to the shop?
- Should an importer who only operates local, urban sites that ship product directly to the shop have different economics from other traditional players?
- Should a traditional commercial channel player price consistently in urban geographies versus rural ones?

Solving these problems would be extremely difficult for any company. Add in the integration of one or more acquisitions with different business models and some major business system enhancements, and the complexity expands exponentially.

On top of all this, channel players and the industry are working to sort out the future of e-tailing. Will newer participants take large amounts of share, or will the internet simply help the current players? **E-tailing will continue to grow but will represent a small portion of the market.** E-tailing represented about $3B or 5% of the U.S. light-vehicle aftermarket parts market in 2013. The amount has been growing more quickly than any other channel of the market at about 13% per year, and it should continue to grow, although at a slower rate. Most of the volume, approximately 80%, is for the DIY market (*Exhibit 32*).

Exhibit 32
Online U.S. Auto Parts Market
($B, 2013-2025F)



Source: Analyst reports, Strategy& analysis

E-tailing for DIFM has been, and will be, extremely confined, since the economics and business models for shops are predominantly built on the presumption of a parts delivery window of an hour, stretching up to three hours, for the vast majority of their needs (*Exhibit 33a-b*).

Lower parts prices have little ability to offset the cost of delayed repairs. Thus, only around 1-2% of DIFM parts are purchased online, and when they are it is most often for parts that not readily available locally – e.g., older vehicle parts, specialty parts. Shop owners and technicians do not expect this situation to change. Likewise, while a small portion of customers buy their own parts for DIFM and shops will at times accept this type of business, it is a very small portion of the market. It is fraught with liability and dissatisfaction risks.

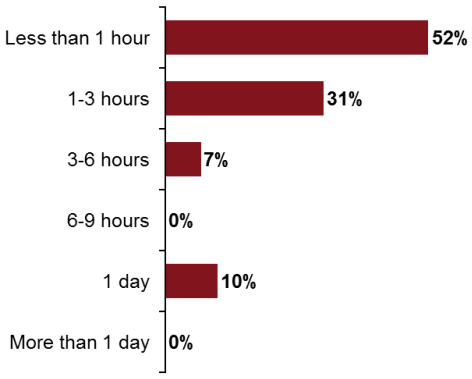
"The convenience provided by internet is largely taken away because aftermarket delivery system is so robust. There is already a high level of convenience."
–Supplier

"There is growing price transparency, but most players in the market recognize there is more to value than price. Otherwise, Amazon would be shipping it all."
–Channel Partner

Going forward, DIFM shops do not expect this business to pick up in any significant way. Instead, more informed consumers will likely squeeze DIFM parts margins, have more say in the parts they receive, and pay higher labor costs for the service that is performed.

Exhibit 33a

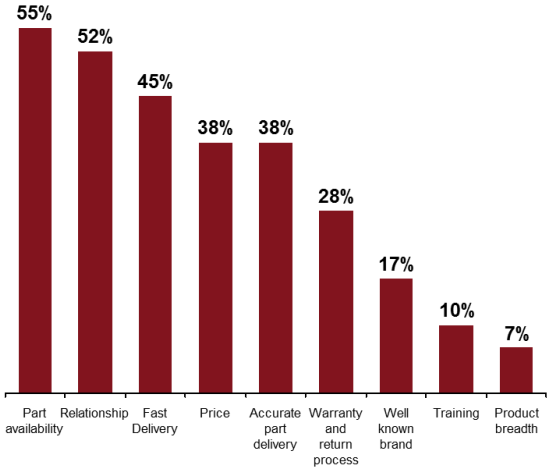
What is the expected delivery time from a jobber or distributor?



Source: 2014 Professional technician's survey, Strategy& analysis

Exhibit 33b

What are your top three reasons for purchasing from a local distributor?



Aside from hard-to-find parts, the primary reason an independent shop would buy from an e-tailer is price savings, but the savings would have to be significant – upwards of 25% (*Exhibit 34a-b*).

Exhibit 34a

What kind of parts do you buy through an e-tailer?

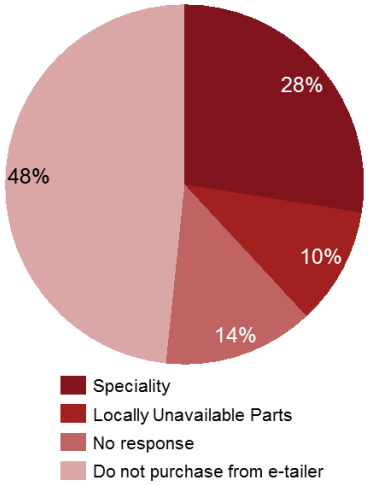
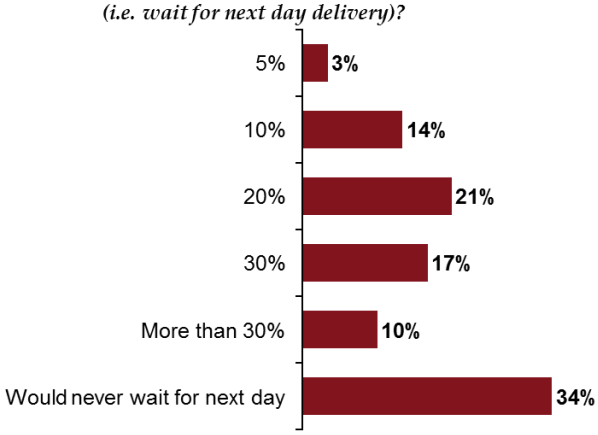


Exhibit 34b

What would be the savings required for you to relax the delivery expectation (i.e. wait for next day delivery)?



Source: Strategy& 2014 Professional Repair Shop Survey, Strategy& analysis

Given unique circumstances and histories, all the major players face different perspectives on the issues discussed above. A cursory view of some of their various positions is below (*Exhibit 35*).

Exhibit 35
Top Channel Players – Key Characteristics

	2013 Revenue ($B)	EBIT Margin	# Stores	Rural Footprint	Same Store Sales: DIFM/DIY	Business / Distribution Model:
NAPA	$7.5	8.10%	6000	49%	3 (25% DIY)	▪ Predominantly focused on DIFM ▪ 3-step distribution
Advanced Auto Parts	$9	10.80%	3794	14%	0.67 (60% DIY)	▪ Mixed model with acquisition of Worldpac and CQ ▪ 2-step and 3-step
Autozone	$9.5	18.90%	4836	12%	0.31 (80% DIY)	▪ Mixed model with acquisition of InterAmerican ▪ 2-step and 3-step
O'Reilly	$7.1	15.70%	4166	16%	0.76 (50% DIY)	▪ Mixed model ▪ 3-step

Source: Analyst reports, Company 10-K Reports and Strategy& analysis

Competition among them will intensify. They all face much tougher roads ahead. Some have difficult tasks to successfully integrate acquisitions they have made. Most are working to capture more DIFM share, as DIY is not growing. They all need to develop more sophisticated business models to deal with several tall challenges – SKU proliferation, multiple target customer segments with very different needs, declining competitiveness of 3-step models, and e-tailing. Only the big will prevail, and some will not survive the ensuing battles.

For the DIFM shops, the intensifying competition among channel players should result in better service, support, and potentially even prices. As with increasing competition in most any industry, the customers (in this case the DIFM shops) should benefit. The big investments in acquisitions, new IT systems, and better supply chain management should be good for channel's customers. The only potential pitfall is that by 2025 not all the channel partners will survive. For the ones that go away, their customers may experience some bumps along the way.

VII. Implications for Suppliers

Among the numerous concerns identified in the Aftermarket Outlook 2020 report in early 2011, three were highlighted as major drivers of change for suppliers: channel consolidation, SKU proliferation, and LCC sourcing. It also anticipated that only those suppliers who invested in building differentiating capabilities consistent with these changes, and specifically adapted their business models to better serve the large, powerful channel partners, would excel. While the continued post-recession cyclical uplift has provided some relief to suppliers, many are still struggling to adjust to the market realities and sustainably earn attractive returns.

Now, looking ahead to 2025 with a focus on DIFM, the previous conclusions are still as important as ever. In addition, suppliers need to ensure their strategies comprehend the new challenges ahead. Future plans should be tested in the following five areas in particular:

A. **Non-dealer DIFM**

For many suppliers DIFM represents the largest customer base. Analyzing independent shops' challenges and needs, and then determining how best to address them, is extremely valuable. Few suppliers really understand these customers well enough. A basic step for suppliers is ensuring their efforts are concentrated on the shops most likely to thrive. Beyond this, suppliers should clearly determine what they can do to help and gain favor with the good shops.

Do I understand how the changes in the non-dealer DIFM market will affect my business? How do I grow share in the DIFM market? What should I be doing to identify and prioritize the strong DIFM players and help them be successful and favor my products (e.g., training, technical support, marketing support, reduce their labor costs)?

B. **Distribution Channel**

As in the prior report, it is critical that suppliers assess scenarios for how their channel partners are likely to fare, determining the impact on their own business under different outcomes, and what they should be doing now as a result. In addition to the restructuring that has already transpired, more consolidation and fierce competition will continue to reshape the channel landscape. It is critical for suppliers to find distinctive ways to help their big customers be successful and, in doing so, make themselves more valuable than their peers.

Do I really know how to best help make my large channel partners more successful and make my business uniquely indispensable them? Do I deeply understand the challenges they are facing, and can I anticipate what they will need in the future? Do I have a good idea of which channel partners will thrive, which will not, and what it means to my business?

C. **Dealers**

As new-vehicle dealers gain share in the market, suppliers should seek ways to capitalize on this shift. Part of the share they will win will consist of non-OES, aftermarket parts, in order to provide an expanded customer base with all-makes and lower-price parts options. So the dealer should be viewed not as a threat but rather as

a growth opportunity. Some suppliers have OES business that will benefit from dealer growth, but any supplier can devise new approaches to create dealer pull for their independent aftermarket products.

Do I recognize that dealers are not the enemy? If I have an OES business, do I know how to make it stronger, given that dealer share will grow? Do I know how to optimize across OES and independent channels? Do I know how to build a business that reaches dealers through independent aftermarket channels, as they increasingly need non-OES product?

D. **Scale**

Consolidation will not only take place among distributors. Suppliers will also combine, as has been the case. Supplier M&A activity will principally be driven by the OE business, because OEM platforms and operations are becoming truly global. Aftermarket operations will bulk up as a result but for additional reasons – e.g., simply as a route to growth given slow overall U.S. market expansion, to reduce the number of players in a product segment, to match up better with huge channel partners, to expand internationally, and to be able to better afford investments in differentiating capabilities.

Many aftermarket suppliers need more scale to service huge channel partners and to fund their strategies, and therefore inevitably will consider M&A. But sheer scale or scope alone is not the right objective. Suppliers should consider deals that help them strengthen their distinctive capabilities required to serve DIFM - people, processes, technology, systems, and knowledge that are a fit with the products and services they offer to the DIFM market. As perhaps the most critical and risky decisions they will make, suppliers need a rock solid understanding of how the different markets will likely evolve.

Do I have the scale I need to be successful? Do I have the investment capacity I require to prosper? If not, what realistic organic and inorganic options for growth do I have? Should I consider international expansion?

E. **Differentiated Value Proposition**

No different from the past, suppliers must have a value proposition beyond purely competitive product, and it needs to be resilient enough to survive the fluctuations of the market. This differentiation, by definition, cannot be the same for all suppliers. Meeting the competitive basics is the price of entry, not enough to generate attractive financial performance. Differentiation can come in many areas, such as product innovation, brand pull, channel support capabilities (e.g., inventory management, merchandising), or cost. Suppliers who thoroughly understand how they can excel in serving the evolving needs of the DIFM shop, continuously reinforce their strength, and subordinate all other costs and demands, will tend to prosper. Those who cannot clearly define, communicate, and deliver on a differentiated position will have even more difficulties as the market evolves.

First, am I competitive on all of the basics – cost, quality, delivery, and basic support such as administration, digital content, channel/customer management? Second, do I truly have a

differentiated and powerful value proposition? Against what portion or segments of the market will it apply? Will it provide me with attractive returns and growth? How strong is it? Will it still be applicable given all the industry trends and changes? What do I need to do to make it even stronger going forward?

* * * * *

So, overall the U.S. aftermarket promises to be more dynamic than ever over the coming decade. Each part of the industry will be reshaped. Accelerating technology advancement will play a major role across the board.

On the **DIFM** shop battleground, survivors and winners will need to embrace technology to help service more complex vehicles, augment their technicians' skills, and greatly enhance the marketing and customer service they provide. In doing so, they will limit inroads by dealers and obviate consolidation. While the structure of the DIFM service provider industry will not change much, their operations will be transformed to better serve their customers. The industry will still mostly consist of single-outlet, independent shops. But many smaller ones who are slower to adopt the requisite technology will cease to exist; their customers will be picked up by other stronger independents, and to a smaller extent by new-vehicle dealers.

The **channel** should remain the most volatile portion of the industry, with more consolidation, intense internecine competition, acquisition integration, complex supply chain challenges, and extensive e-commerce impacts ahead. Suppliers need to be prepared for various outcomes in the channel, and cannot take any solace that they have little left to give to support the future growth of channel partners' shareholder value. As the channel partners battle each for DIFM market share and make their portion of the value chain more competitive, the shops will profit from the advances. At the same time, suppliers need to ensure they are working with the best possible channel partners and not falling behind their progress.

Suppliers must continue to excel at the basics – quality product, competitive price, reliable delivery, robust content, and customer support are only table stakes. Suppliers also need to build new capabilities just to stay in the game, given rapid penetration of new technologies in vehicles, in servicing vehicles, and in serving aftermarket customers. Lastly, suppliers must have a true, valuable differentiation that they continuously enhance to excel in the aftermarket. Suppliers (or channel partners) who find creative, modern ways to help these key customers (e.g., training, technical support, installation labor reduction innovations, marketing support, loyalty programs) can benefit greatly.

VIII. Appendix

Exhibit A1
Sample of Supplier and Channel Interviewees

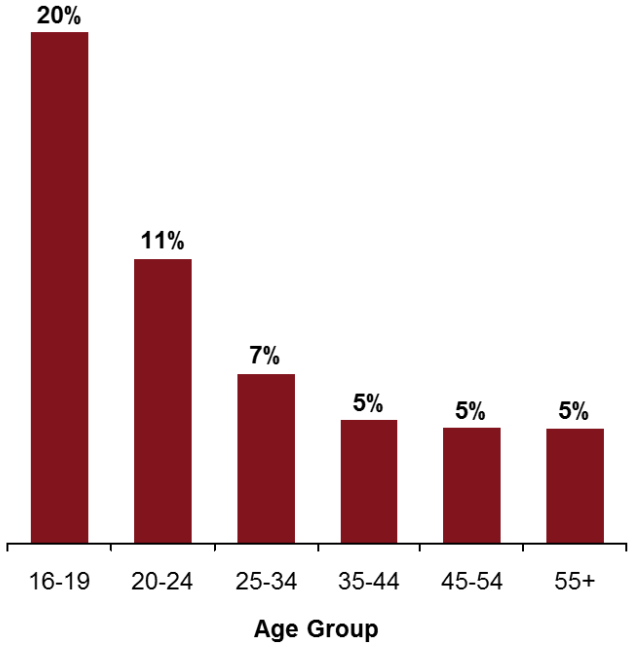
#	Company	Type
1	AC Delco	Supplier
2	Advance Auto Parts	Channel
3	Aftermarket Auto Parts Alliance	Channel
4	AutoZone	Channel
5	Bosch	Supplier
6	Cardone	Supplier
7	Continental	Supplier
8	Dayco/Mark IV	Supplier
9	Delphi	Supplier
10	Dorman	Supplier
11	eBay Motors	Channel
12	Exide	Supplier
13	FDP Brakes	Supplier
14	Federal Mogul	Supplier
15	Gates	Supplier
16	MAHLE Clevite	Supplier
17	O'Reilly	Channel
18	Pep Boys	Channel
19	Pronto	Channel
20	Remy	Supplier
21	Sears	Channel
22	SKF	Supplier
23	Snap-On	Supplier
24	Standard Motor Products	Supplier
25	Tenneco	Supplier
26	TI Automotive	Supplier
27	Timken	Supplier
28	TRW	Supplier
29	UCI-FRAM	Supplier
30	Valvoline Company	Supplier
31	WorldPac	Channel
32	ZF	Supplier

Exhibit A2
Macroeconomic indicators used in Econometric Models 2011-2025f

Year	Real GDP Growth	Fed Funds Rate	Median House Prices ($)	Unemployment	Oil Price Change	Urban Population Share	US Population (M)
2011	1.6%	0.1%	$227,200	8.9%	22.6%	82.4%	311.59
2012	2.3%	0.1%	$245,200	8.1%	1.2%	82.6%	313.91
2013	2.2%	0.1%	$268,900	7.4%	-4.6%	82.9%	316.16
2014	2.2%	0.1%	$277,804	6.4%	1.7%	83.1%	318.58
2015	2.4%	0.8%	$286,860	6.6%	-1.9%	83.4%	321.36
2016	2.4%	1.2%	$296,216	6.2%	-2.2%	83.6%	323.85
2017	2.4%	1.8%	$305,882	5.9%	-1.0%	83.8%	326.35
2018	2.4%	2.0%	$315,868	5.8%	-1.1%	84.1%	328.86
2019	2.4%	2.4%	$326,185	5.7%	-1.1%	84.3%	331.38
2020	2.3%	2.8%	$336,843	5.7%	-1.0%	84.6%	333.90
2021	2.3%	2.8%	$347,855	5.6%	-1.0%	84.8%	336.42
2022	2.3%	3.4%	$359,230	5.6%	-1.0%	85.1%	338.93
2023	2.3%	3.7%	$370,983	5.5%	-1.0%	85.3%	341.44
2024	2.3%	3.7%	$383,125	5.5%	-1.0%	85.6%	343.93
2025	2.3%	3.7%	$395,668	5.5%	-1.0%	85.8%	346.41

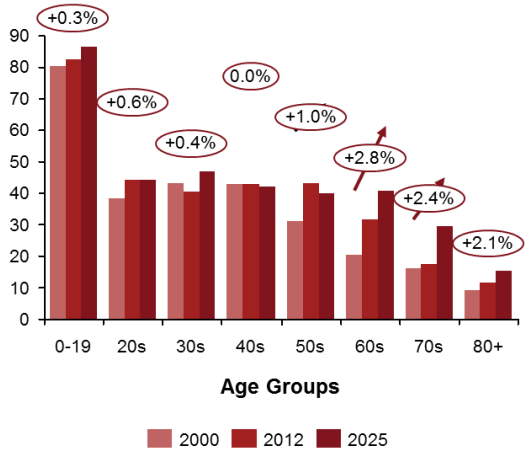
Sources: IMF World Economic Outlook; Goldman Sachs; UC Berkeley Fisher Center for Real Estate; Census; Energy Information Administration of DOE; World Bank; *Global Insight*; Strategy& analysis

Exhibit A3
U.S. Unemployment by Age Group (2014)



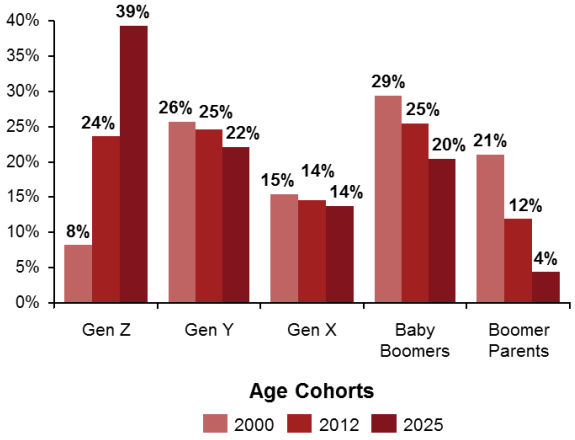
Source: U.S. Bureau of Labor Statistics, Strategy& analysis

Exhibit A4
Population Size by Age Group Over Time
(M People; 2000, 2012, 2025)



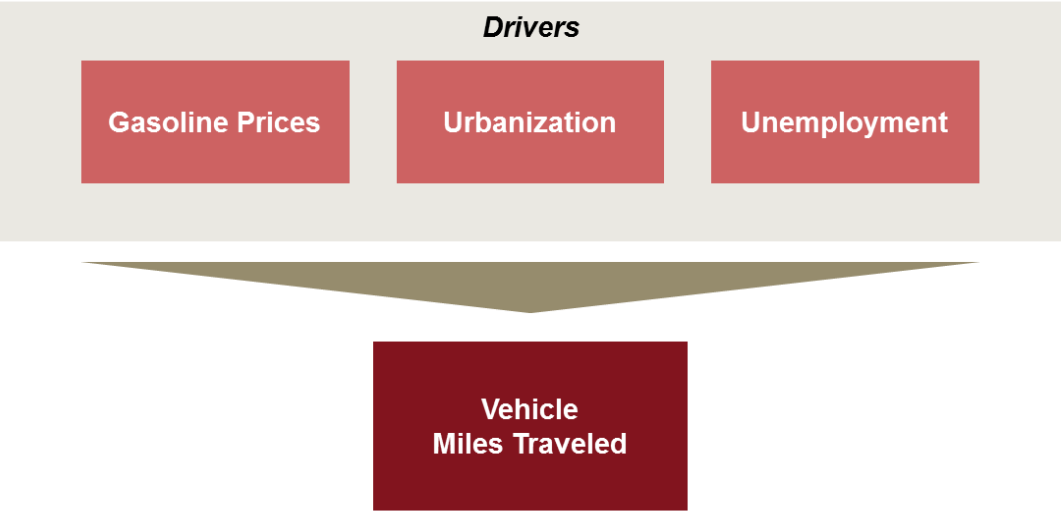
Sources: U.S. Census, U.S. News, Transportation Research Institute, Strategy& analysis.

Exhibit A5
Population Share by Age Cohort Over Time
(% Population; 2000, 2012, 2025)



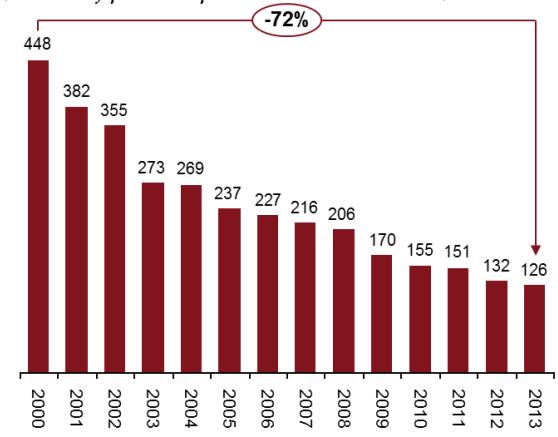
Sources: U.S. Census, U.S. News, Transportation Research Institute, Strategy& analysis.

Exhibit A6
Vehicle Miles Traveled Model



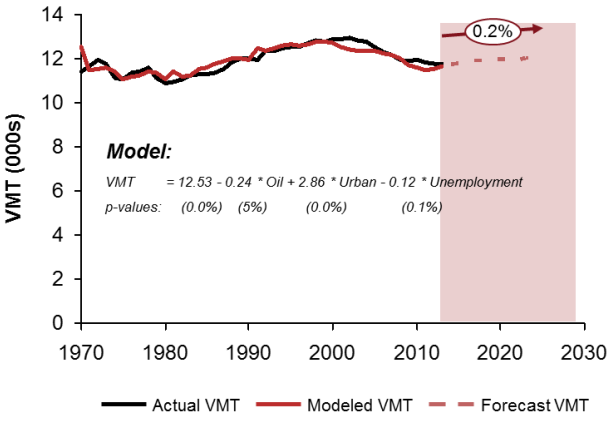
Sources: Strategy& analysis.

Exhibit A7
Industry Avg. Vehicle Dependability
(Number of problems per 100 vehicles 2000-2014)



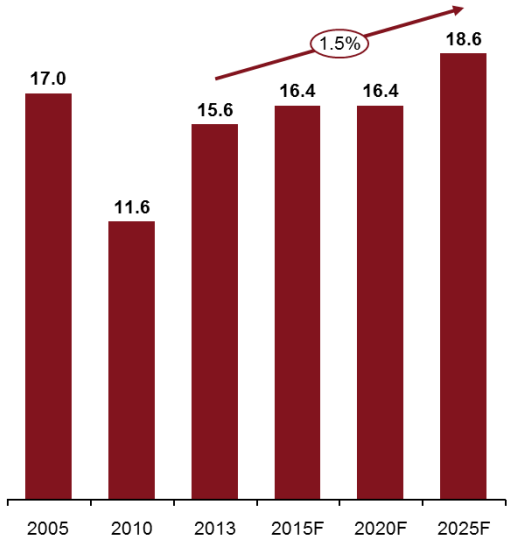
Sources: J.D. Power Vehicle Dependability Survey, Strategy& analysis

Exhibit A8
Historical and Estimated Miles Traveled
1970-2025 ('000 annual miles per vehicle)



Sources: BLS, Strategy& analysis

Exhibit A9
Light Vehicle Sales Forecast (millions)



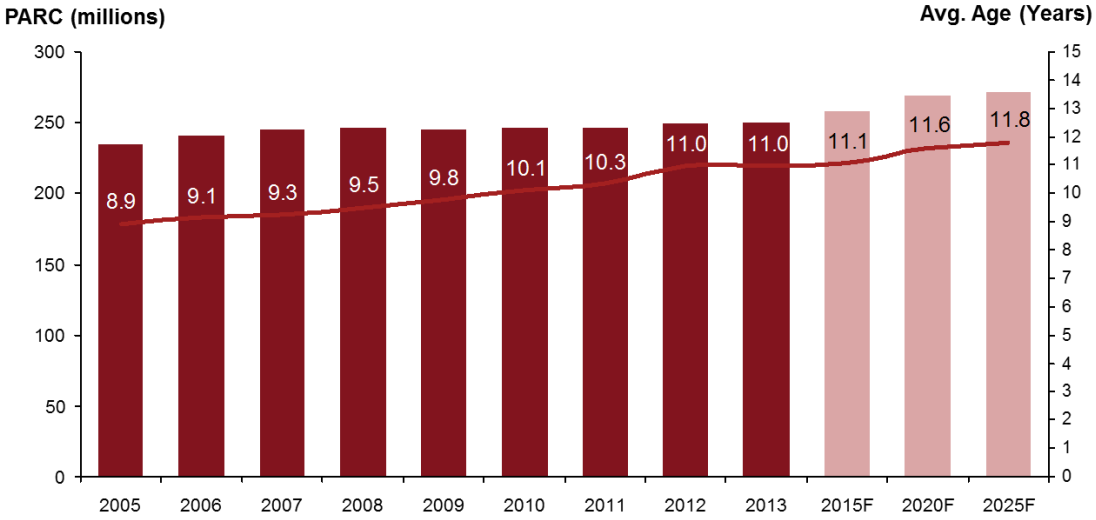
Source: IHS

Exhibit A10
Scrappage Rates

Year	Cars	Lt. Trucks
2000	6.4	7.4
2001	6.0	7.1
2002	5.6	7.2
2003	5.2	6.0
2004	4.8	4.7
2005	4.5	4.1
2006	4.9	5.2
2007	5.5	4.9
2008	5.1	6.4
2009	7.7	4.2
2010	5.3	3.5
2011	5.8	3.8
2012	4.8	3.5
2013	5.4	3.4

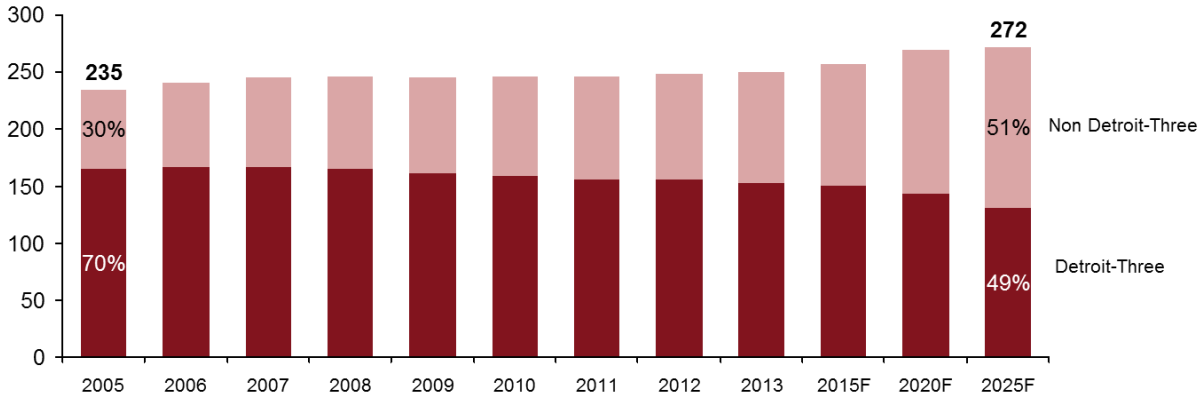
Source: Wards Auto

Exhibit A11
Average age of PARC



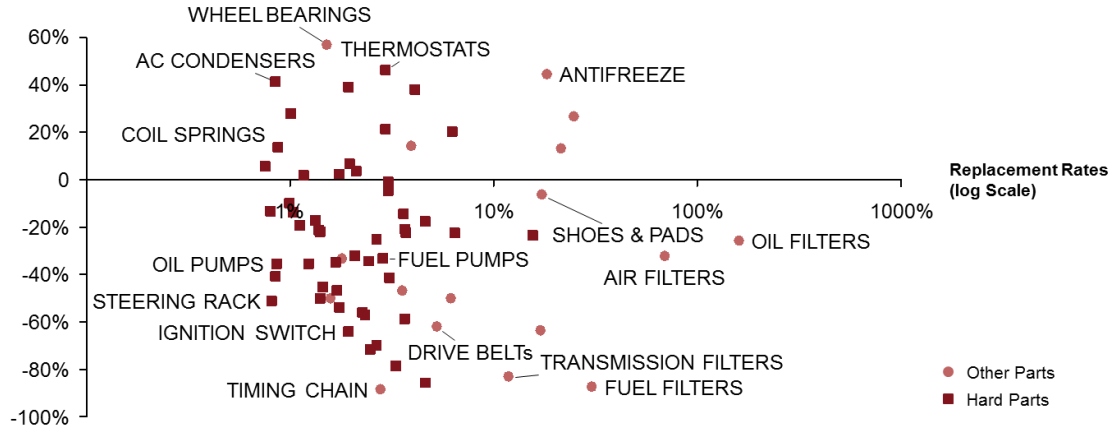
Source: IHS, Ward's Auto, Strategy& analysis

Exhibit A12
Vehicle PARC – Non-Detroit Three Nameplate penetration



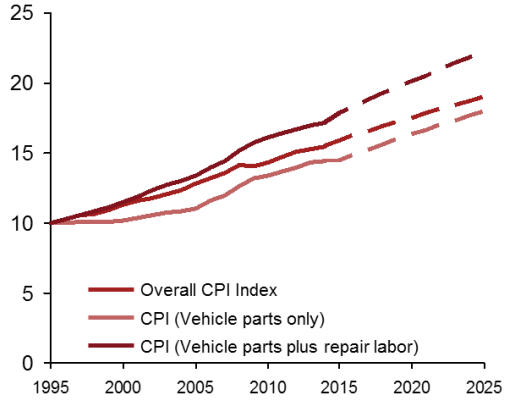
Source: IHS , Ward's Auto Strategy& analysis

Exhibit A13
Replacement Rates Trends (% Change in Replacement Rates 2005 and 2013 vs. Replacement Rates in 2005)

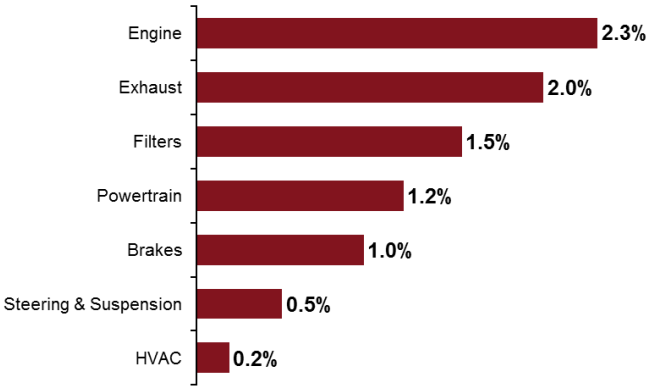


Source: IMR, Strategy& analysis

Exhibit A14
Automotive Parts and Repair Prices
(Index, 1995=10)

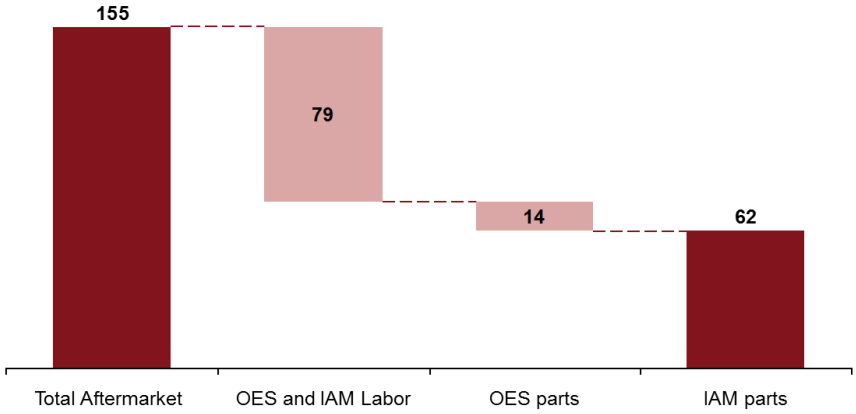


Source: BLS



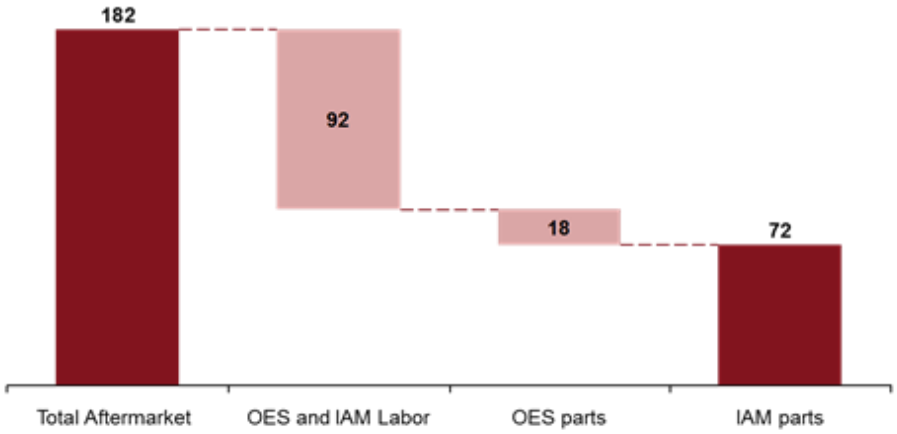
Source: Census Bureau

Exhibit A16
Automotive Aftermarket Market Size (2013 $B)



Source: Strategy& analysis

Exhibit A17
Automotive Aftermarket Market Size (2025 $B)



Source: Strategy& analysis

Exhibit A18
Major Factors Contributing to IAM Market Size (2013– 2025 $B)

Source: Strategy& analysis