Hilco Smarter Perspectives: Automotive Parts

Q2 2020

Aftermarket Parts Industry Makes the Most of a Bad Situation

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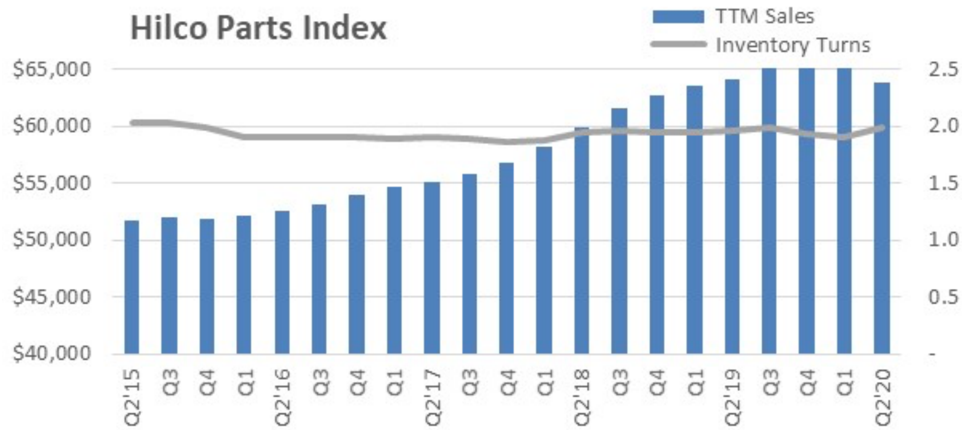

Hilco Parts Index (HPI) : Advance Auto Parts, AutoZone, Genuine Parts, LKQ, O'Reilly Auto Parts, and Uni-Select

August 31, 2020 – For the first time, in a very long time, the trailing twelve-month (TTM) net sales for the Hilco Parts Index (HPI) decreased from year-ago levels. HPI companies were flush with inventory at the beginning of the quarter in preparation for the usually strong spring selling season. When the pandemic took hold in March, everyone would have preferred to have the "cash" as opposed to the extra inventory. However, when sales began to recover, and replenishment stock was not readily available, the inventory proved to be a godsend. Although sales were down for the quarter overall, there was sequential improvement month-to-month. No one is expecting sales to recover to pre-COVID levels for at least a year, but early sales results for the third-quarter are supporting a continued positive trend.

Retail sales outperformed commercial sales during the quarter. It is evident from the sharp upturn in retail sales that the receipt of governmental stimulus payments under the CARES Act was the first catalyst supporting sales growth which was then supplanted by the enhanced unemployment benefits as the quarter progressed. DIFM did not start to turn around until the reopening of the economy and the partial recovery of mile driven. Appearance (car care), accessory, and performance (hobby-related) categories performed particularly well. These categories typically perform at an average level at best during a normal recession, when people defer discretionary spending. This time around, however, people have more time on their hands and more discretionary income because there are fewer alternatives (sports, events, restaurants) on which to spend their money.

Before the end of the first quarter, most companies had already implemented cost savings measures in an effort to be prepared for the worst. It is difficult to plan for something that no one in the modern era has ever experienced before. One industry chief executive, for example, characterized the quarter just ended as the "most remarkably difficult quarter ever experienced." But the hard decisions made in the waning hours of the first quarter began to pay dividends in the second. Gross margins for HPI companies improved by 43 basis points from the prior quarter and 77 basis point from the prior year. In so many words, the chief executives of these aftermarket parts companies have promised to leverage the hard lessons learned and to explore ways to make the temporary savings permanent.

About the Index: The Hilco Parts Index is comprised of six publicly traded companies that distribute aftermarket parts, namely Advance Auto Parts (Advance), AutoZone, Genuine Parts (NAPA), LKQ, O'Reilly Auto Parts (O'Reilly), and Uni-Select. Advance, AutoZone, NAPA, and O'Reilly are the four traditional parts distributors in North America with strong commercial (do-it-for-me or DIFM) and retail (do-it-yourself or DIY) programs. Uni-Select is a much smaller distributor with a strong presence in Canada and LKQ is largely a distributor of recycled (used) parts, as opposed to new parts.

Sales	Gross Margin	Net Margin	Inventory	Inventory Turns
$63,878	43.0%	6.1%	$18,333	2.0
- 1.9% QOQ	+ 43 bp QOQ	- 92 bp QOQ	- 6.2% QOQ	+ 0.1 QOQ
- 0.4% YOY	+ 77 bp YOY	- 89 bp YOY	- 2.9% YOY	No Change YOY

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