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Investors Swerved Away from Deals for Auto Parts Stores Last Year

Some Appear Wary About Online Competition

The biggest U.S. auto parts chains continue to see revenues in the green but many investors touched the brakes last year in buying the real estate those retailers occupy.

Deals for “net lease” auto parts stores fell about 13 percent from 2017 while total deals for net lease properties across the board increased by 4 percent in 2018, according to a report from The Boulder Group, a net-lease advisor based in Willamette, Illinois.

Advance Auto Parts, O’Reilly Auto Parts and AutoZone, each of which are considered investment grade, are the three bellwether retailers for the segment since they dominate the sector. For free-standing locations, the retailers sign leases that put the responsibility of property taxes and insurance on them instead of the landlord. AutoZone tends to do leases for the ground below a store it builds while a landlord tends to own the buildings with the other two.

The Boulder Group noted that growing sales at online retailers like Amazon is part of the reason some investors swerved away from auto parts stores. Investors grew concerned that ecommerce shops would strip sales from brick-and-mortar stores, according to the report.

They had good reason. In late 2016, Amazon began a big push into the auto parts market when it signed contracts with the largest auto parts makers in the U.S. Wall Street responded by punishing the brick-and-mortar retailers by sending their stock prices in a nosedive.

But the retailers continued showing increases in sales and stock prices recovered. They also started adapting by cutting expenses, building up their online presence and speeding up parts delivery.

The retailers have an advantage over Amazon: the personal touch of customer service. “Amazon can’t come out and change the wiper blades or battery,” said Barry Wolfe, senior managing direct investments for Marcus & Milchap in Fort Lauderdale, Florida. Still, Wolfe said, brick-and-mortar retailers “can’t pretend that they are Amazon-proof.”

While concern over Amazon has subsided some, the market for these deals remains tight for existing stores. Investors typically like these deals because of a low price point to buy. “Outside of dollar stores, there is a limited supply of net leased properties available under $2 million leased to investment-grade-rated tenants,” according to the Boulder Group. The stores also tend to be in good locations, offering landlords some fallback should they need to find a new tenant.

Another factor for the tight market involves the investors themselves. Since the retailers sign long-term leases, some as much as 20 years, “people who buy them tend to hold onto them a long time,” Wolfe said.

Supply of new stores could shift in the coming years. Over the past five years, Advanced Auto Parts has closed more stores than it has opened. In 2014, it had 5,372 stores and now has 5,109, according to its most recent Securities and Exchange Commission filing. Last year alone, the Raleigh, North Carolina company closed 101 stores and opened 27. The company has been closing underperforming stores as part of plan to slash expenses.

In its latest quarterly report, Springfield, Mo.-based O’Reilly said it would be adding between 200 to 210 stores this year. If they are leased, they likely would fetch good prices with yields lower than the others since the stores come with a lease that typically runs 20 years.
AutoZone, a Memphis-based company that has 5,163 stores, reported in its most recent quarterly report that the company plans to invest in new stores but didn’t give guidance on a number.

While Amazon’s muscle still looms, the experts remain bullish on this type of real estate because the category appears to perform relatively well during economic downturns. Camille Renshaw, chief executive officer and co-founder of New York-based net-lease brokerage firm B+E, said the auto parts stores tend to do well during recessions because many shoppers shift to do-it-yourself repairs to save on personal expenses.

In an up economy, Renshaw said the stores can serve as a good hedge. “We try to put them in everyone’s portfolio,” she said.