

# the aftermarket analyst

A PUBLICATION FOCUSED ON MERGERS, ACQUISITIONS AND CORPORATE FINANCE IN THE AUTOMOTIVE AFTERMARKET INDUSTRY

## A Catalytic Converter for the Auto Aftermarket: How Private Equity is Transforming the Industry

The rush of private equity capital into the auto aftermarket is rapidly transforming both the companies that receive the money and the dynamics of the industry overall. The following are some of the more important ways this is happening:

**Increased operational efficiency.** Private equity firms make certain that the companies in which they invest have optimal human resources, financial controls, IT systems, procurement, and operational procedures to ensure that they are run as profitability and efficiently as possible.

In an industry where many owners don't know their own company's gross margins, even simple operational improvements can significantly increase profitability.

**Bigger, better financed companies.** Historically, the aftermarket has been a highly fragmented industry with few well capitalized players. However, many of the companies that have received private equity capital have had the resources to grow both organically and through acquisitions.

Keystone and MSD Ignition are good examples of this. These companies have expanded to the point where it is now hard to imagine any company overtaking them anytime soon. Companies like these

will continue to stifle and gobble up competitors as their size and market power proliferates.

**More competitive market environment.** With bigger and better financed companies comes a much more competitive business environment in the industry. Many companies will be made or broken during this wave of the industry's consolidation cycle. Those with strong capital partners have the greatest chance of survival and long term success.

**Focus on growth and shareholder value.** Private equity firms are most concerned with rapidly growing the EBITDA of their portfolio companies because EBITDA growth, more than anything else, leads to increased shareholder value. The more quickly a private equity firm can increase a company's value, the higher the investment returns it generates and the more easily it can raise future funds.

With more capital than ever available for aftermarket companies, overall industry growth will accelerate as companies are able to spend more on hiring, product development, marketing, acquisitions, and other profitable projects.

**Stronger management teams.** It has become axiomatic that private equity firms invest in companies with strong management teams. This is because they usually do not have the resources to manage companies themselves. This fact has created a bull market for auto aftermarket management talent.

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**RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS**

Announce Date	Acquirer/Investor(s)	Target	Target Description	Firm Value (\$mil.)	Rev. FV / Rev.	EBITDA FV / EBITDA
2/23/2006	The Bosch Group and MANN+HUMMEL	ArvinMeritor's Light Vehicle Aftermarket Purolator filters business	Supplier of filtration products including air, oil, and fuel filters	—	—	—
2/14/2006	Transamerican Auto Parts Company, LLC	Four Wheel Drive Hardware, LLC	Catalog and internet retailer of Jeep aftermarket parts and accessories	—	—	—
2/10/2006	Quantum Fuel Systems Technologies Worldwide, Inc.	Regency Conversions, Inc.	One of the largest vehicle converters in North America, producing approximately 5,000 vehicles annually which are sold through 250 automobile dealerships throughout the continental U.S.	10.9	40.0 0.27x	—
2/1/2006	LKQ Corporation	Transwheel Corporation	Aluminum alloy wheel refurbishing and distribution business	—	28.5	—
1/24/2006	Harbour Group	Alemite LLC	Designs and manufactures a wide range of lubrication equipment sold into the auto aftermarket and industrial industries	—	—	—
1/23/2006	Hampton Products International Corporation	Keeper Corporation	Manufacturer of automotive cargo management products	—	—	—
1/18/2006	Industrial Enterprises of America, Inc.	Pitt Penn	Supplier of automotive and chemical products	—	—	—
1/18/2006	Kirtland Capital Partners	Crysteel Manufacturing Inc.	Manufacturer of light and medium dump and platform bodies and hoists	—	—	—
1/9/2006	Bridgestone/Firestone Retail and Commercial Operations	ProCare Automotive Service Solutions	Retailer in automotive service industry with 92 locations	—	—	—
1/9/2006	Monomoy Capital Partners LLC	Barjan Products LLC	Largest distributor of nonfood general merchandise, such as automotive accessories, toys, sunglasses, books and videos to truck stops and travel centers in the U.S.	20.0	140.0 0.14x	—
1/6/2006	Investcorp SA	Autodistribution SA	France's largest independent distributor of auto, truck and industrial parts	729.0	—	—
1/4/2006	Harbour Group	Late Great Chevrolet Association, Inc.	Sells a complete line of interior and exterior parts and accessories directly to retail customers through several specialty catalogs and a monthly membership publication, Chevy Times	—	—	—
1/3/2006	LKQ Corporation	Fit-Rite Body Parts	Aftermarket collision automotive replacement parts business	37.0	39.6 0.9x	—
12/30/2005	General Cable Corporation	Beru S.A. de C.V.	Automotive aftermarket assembly and distribution operation	—	—	—
12/21/2005	Capital Partners	Dayton Parts, LLC	Manufacturer and distributor of aftermarket heavy duty truck parts	—	—	—
12/16/2005	Bear Stearns Merchant Banking	Transamerican Auto Parts Company Inc.	Retailer and distributor of specialty aftermarket parts and accessories for light trucks, Jeeps, sport utility vehicles and other four-wheel drive vehicles	100.0	—	—
12/6/2005	LKQ Corporation	A-Reliable Auto Parts	Operates from three locations, two that sell primarily into the retail market and one that sells into the professional repair market	—	26.9	—
12/1/2005	Greenbriar Equity Group LLC	Western Peterbilt, Inc. and Western Truck Parts and Equipment Company LLC	Operator of heavy-duty truck dealerships in the Pacific Northwest	—	—	—
12/1/2005	CSK Auto Corp.	Murray's Inc.	Operates 109 auto parts retail stores throughout the Midwest	170.0	235.0 0.72x	—
11/29/2005	Uni-Select USA, Inc.	The Kunz Oil Company	Operates a distribution center and three branch locations for automotive replacement parts in Minneapolis, Minnesota and adjoining suburbs	—	10.0	—

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As a result, managers are getting wealthy at a faster rate than at any other time in the history of the industry.

For example, consider a CEO who is awarded stock options for 10 percent of his company in a management-led buyout. Assuming this executive is able to successfully grow the company's earnings at double digit rates over a five to seven year period, he could expect to reap a multi-million dollar windfall when the company is sold or taken public. Compared to a six figure salary with an annual bonus, this is a much faster way to get wealthy.

**Emphasis on long term planning.** Few privately held, family-owned businesses have taken the time and effort to develop a long term corporate plan. This isn't surprising given that most are highly entrepreneurial organizations marked by a more intuitive, "seat of the pants" decision making style.

With millions of dollars of institutional money at stake, private equity firms can little afford a less than methodically planned strategy. In order to increase their odds of making a successful investment, corporate goals and objectives are careful researched, documented, implemented, and measured.

Although not always successful, implementing this kind of rigor and discipline to the corporate planning process increases the probability of long term corporate success.

Furthermore, having some sort of strategy for China is something all private equity firms take very seriously. Contrasted with many businesses in the industry that have taken little or no thought regarding this manufacturing juggernaut, one can see how private equity might benefit many companies in the industry.

**Higher valuations.** With more capital than ever looking for a home in the auto aftermarket, pricing has gotten significantly more competitive. Consequently, owners who have sold in the last year have gotten much better deals than they would have several years ago.

We expect valuations to remain strong throughout 2006 and beyond. However, if the economy takes a turn for the worse and lenders tighten up, valuations are sure to drop in tandem.

**Greater liquidity.** Several years ago, companies with less than \$5 million in EBITDA had limited options when it came time to selling their privately-held shares. Traditionally, strategic buyers were the only entities providing liquidity to this segment of the market.

Increasingly though, private equity firms are targeting smaller companies for buyouts because this industry segment is seen as one of the few remaining that is less than efficient and can, therefore, generate outsized returns.

## About Capstone

Capstone Financial Group is an investment banking firm which assists owners of middle market companies with their financial needs - including mergers and acquisitions, recapitalizations, private placements, divestitures, and other financial advisory services. Capstone is backed by a highly experienced and knowledgeable team of financial professionals with firsthand knowledge of starting, operating, growing, and selling middle market companies. Visit us online at [www.capfg.com](http://www.capfg.com).

**Selected Public Company Capitalization and Operating Figures**  
 (\$ in millions, except per share data)

Company	Price as of 2/27/06	Enterprise Value				Last Twelve Months (LTM)			Net Income
		Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	
<b>Manufacturers</b>									
Tenneco Automotive Inc.	\$21.08	\$925.9	\$1,412.0	\$66.0	\$2,361.3	6/30/05	\$4,348.0	\$369.0	\$25.6
Standard Motor Products, Inc.	11.06	219.5	294.8	13.6	500.9	9/30/05	839.2	27.6	(4.8)
Aftermarket Technology Corp.	21.68	470.0	92.4	42.1	531.9	9/30/05	427.1	65.8	30.2
R&B, Inc.	11.36	203.7	34.7	3.2	238.0	9/24/05	268.7	34.4	16.7
Proliance International, Inc.	5.31	81.0	50.4	5.2	126.9	9/30/05	309.5	5.2	(7.1)
<b>Wholesalers &amp; Distributors</b>									
Genuine Parts Company	\$44.63	\$7,744.3	\$500.9	\$339.5	\$8,040.5	9/30/05	\$9,626.7	\$747.9	\$424.8
LKQ Corporation	22.20	559.3	55.6	4.3	653.1	9/30/05	517.2	55.5	27.7
Keystone Automotive Industries, Inc.	34.92	558.9	0.4	6.6	567.3	9/30/05	573.2	32.5	15.9
The Coast Distribution System, Inc.	7.30	32.3	19.2	0.7	52.6	9/30/05	174.5	8.4	3.8
<b>Retailers</b>									
Autozone, Inc.	\$98.91	\$7,589.0	\$1,789.8	\$81.4	\$9,432.9	11/19/05	\$5,762.8	\$1,105.4	\$562.9
Advance Auto Parts, Inc.	41.64	4,504.5	470.5	112.7	4,938.8	10/8/05	4,150.1	510.8	229.1
O'Reilly Automotive, Inc.	31.85	3,569.7	100.9	51.6	3,619.1	9/30/05	1,958.0	279.7	146.8
The Pep Boys - Manny, Moe & Jack	15.90	861.3	534.0	36.5	1,364.5	10/29/05	2,241.8	80.0	(22.6)
CSK Auto Corporation	16.16	708.0	395.1	19.3	1,095.2	10/30/05	1,594.5	121.9	31.3

**Selected Public Company Multiples and Operating Statistics**

Company	Enterprise Value /					P / E Ratio	Margins		
	Revenue	EBIT	EBITDA	Free Cash Flow (2)	Net Income		Gross Margins	EBITDA Margins	Net Margins
<b>Manufacturers</b>									
Tenneco Automotive Inc.	0.5x	12.4x	6.4x	10.3x	92.2x	36.2	15.5%	8.5%	0.6%
Standard Motor Products, Inc.	0.6x	53.4x	18.1x	29.8x	NM	NM	20.9%	3.3%	NM
Aftermarket Technology Corp.	1.2x	10.4x	8.1x	10.7x	17.6x	15.6	24.1%	15.4%	7.1%
R&B, Inc.	0.9x	8.2x	6.9x	9.4x	14.2x	12.2	35.9%	12.8%	6.2%
Proliance International, Inc.	0.4x	NM	24.4x	NM	NM	NM	17.9%	1.7%	NM
<b>Mean</b>	<b>0.7x</b>	<b>21.1x</b>	<b>12.8x</b>	<b>15.0x</b>	<b>41.3x</b>	<b>21.3x</b>	<b>22.8%</b>	<b>8.3%</b>	<b>4.6%</b>
<b>Median</b>	<b>0.6x</b>	<b>11.4x</b>	<b>8.1x</b>	<b>10.5x</b>	<b>17.6x</b>	<b>15.6x</b>	<b>20.9%</b>	<b>8.5%</b>	<b>6.2%</b>
<b>Wholesalers &amp; Distributors</b>									
Genuine Parts Company	0.8x	11.8x	10.8x	12.1x	18.9x	18.2	31.4%	7.8%	4.4%
LKQ Corporation	1.3x	13.7x	11.8x	16.3x	23.6x	20.2	45.4%	10.7%	5.3%
Keystone Automotive Industries, Inc.	1.0x	23.7x	17.4x	19.7x	35.6x	35.0	44.0%	5.7%	2.8%
The Coast Distribution System, Inc.	0.3x	6.9x	6.2x	6.7x	13.8x	8.5	18.5%	4.8%	2.2%
<b>Mean</b>	<b>0.8x</b>	<b>14.0x</b>	<b>11.6x</b>	<b>13.7x</b>	<b>23.0x</b>	<b>20.5x</b>	<b>34.8%</b>	<b>7.3%</b>	<b>3.7%</b>
<b>Median</b>	<b>0.9x</b>	<b>12.7x</b>	<b>11.3x</b>	<b>14.2x</b>	<b>21.3x</b>	<b>19.2x</b>	<b>37.7%</b>	<b>6.7%</b>	<b>3.6%</b>
<b>Retailers</b>									
Autozone, Inc.	1.6x	9.8x	8.5x	11.5x	16.8x	13.5	49.1%	19.2%	9.8%
Advance Auto Parts, Inc.	1.2x	12.4x	9.7x	16.6x	21.6x	19.7	47.2%	12.3%	5.5%
O'Reilly Automotive, Inc.	1.8x	16.1x	12.9x	43.7x	24.7x	24.3	43.3%	14.3%	7.5%
The Pep Boys - Manny, Moe & Jack	0.6x	NM	17.1x	NM	NM	NM	24.3%	3.6%	NM
CSK Auto Corporation	0.7x	12.8x	9.0x	12.2x	35.0x	22.6	45.4%	7.6%	2.0%
<b>Mean</b>	<b>1.2x</b>	<b>12.8x</b>	<b>11.4x</b>	<b>21.0x</b>	<b>24.5x</b>	<b>20.0x</b>	<b>41.8%</b>	<b>11.4%</b>	<b>6.2%</b>
<b>Median</b>	<b>1.2x</b>	<b>12.6x</b>	<b>9.7x</b>	<b>14.4x</b>	<b>23.1x</b>	<b>21.1x</b>	<b>45.4%</b>	<b>12.3%</b>	<b>6.5%</b>

(1) Enterprise Value equals market cap, plus debt, minus cash

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful