



AFTERMARKET ANALYST

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

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Be sure to log on to Capstone's SEMA sponsored webinar, **"Serious Capital for Serious Companies: Increasing the Value of Your Business With Other Peoples' Money"**, Tuesday, May 18th at 10:00AM (PST)

If you would like to receive an electronic or hard copy of the *Aftermarket Analyst* or more information on the capital markets as they relate to the *Automotive Aftermarket*, please contact Jon Taylor, Senior Associate, Capstone Financial Group at (843) 689-6450 or jon@capfg.com.

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Capstone Financial Group

11 Palmetto Pkwy, Suite 104
Hilton Head, SC 29926

Phone: (843) 689-6450

Fax: (843) 681-5938

Web site: www.capfg.com

CALI MANUFACTURERS FACE UPHILL BATTLE

Home to more than 30% of all automotive aftermarket manufacturers, California has been the industry's center of gravity since its inception. However, significant and costly deterioration in the Golden State's business climate in recent years has caused many aftermarket business owners to consider alternative locations for their manufacturing operations.

Some of the more egregious developments strangling California manufacturing concerns are as follows:

1. Workers' compensation insurance. Notorious for its fraud and corruption, California's workers'

compensation system is the most expensive in the nation. Business groups such as the National Federation of Independent Business have identified the state's workers' comp program as one of the top killers of businesses and jobs.

2. Energy prices. Deregulation, growing demand, static supply, and other factors have contributed to inordinately high energy prices in recent years.

3. Taxes. California ranks 49th in business climate in the U.S. according to the Tax Foundation; only the state of Mississippi holds a lower ranking. Furthermore, a

budget deficit running into the tens of billions of dollars means that tax relief in the near future is unlikely.

4. Regulation. Environmental and other forms of regulation have proliferated and become more onerous in recent years.

While several off-shore locations may prove better manufacturing environments than California, for those aftermarket companies looking to stay in the U.S., South Carolina warrants close consideration.

Trailing only its tourism and textile industries, South Carolina's automotive cluster
(Continued on page 4, see "California")

FOUR REASONS TO REVISIT DIVESTITURES

The percentage of deals with strategic buyers—typically corporations—is shifting fast: research shows that activity by strategic buyers has decreased consistently since 2000, while financial buyer (private equity group) transactions have held fairly steady. The numbers show that financial buyers were responsible for just under 20 percent of acquisitions in the first half of 2003, up from about 12 percent in 1999. Their prominence has grown even more rapidly in sectors such as technology.

What's driving that trend?

Two overriding factors: one market-driven, the other particular to financial buyers right now. First, depressed stock prices are poor transaction currency and business confidence still wavers. Most businesses are waiting for the economy to

stabilize and for pipelines to fill before they can feel good about making acquisitions. Today, many private equity firms have larger funding pools, meaning they're able to pursue a wider range of possibilities—including spin-offs of big companies. In addition, many equity providers now have their own captive debt funds so they can provide "one-stop shopping."

There are four strong reasons why CEOs and corporate development officers should be revisiting their divesting options now:

1. Cash is king—Financial buyers pay cash; corporate buyers may not. Cash is transparent and relatively uncomplicated, particularly when compared to securities. When stock is used as purchase currency, there has to be agreement on what class of stock, and it

must be professionally valued and revalued as the transaction stretches out.

2. Flexibility is better—Financial buyers can be flexible with the type of transaction—from a 100% buyout to a minority stake. If the stake is less than 100%, the seller can benefit from a "second bite at the apple"—a larger payout when the spin-off has an exit event such as a public offering.

3. Agendas are out in the open—Corporate buyers can be competitors with whom the selling companies prefer not to deal. Agendas may be misleading; if another company's due diligence exercise turns out to have been a ploy to glean valuable competitive information, the losses are obvious. Financial buyers' incentives are plain;

(Continued on page 4, See "Divest")

RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS

Announce Date	Acquirer	Target	Target Description
3/4/2004	Replacement Parts Inc.	Dimmick Supply Co.	Distributes auto parts
3/4/2004	First Atlantic Capital Ltd.	Prestolite Electric Holding Inc.	Manufactures alternators and starter motors
3/1/2004	Wetherill Associates Inc.	Transpo Inc.	Manufacturer of automotive electronics for the automotive electric aftermarket
2/23/2004	LKQ Corporation	Global Trade Alliance, Inc.	Supplier of aftermarket collision automotive replacement parts
2/20/2004	General Parts Inc.	Strafco (a.k.a. Straus-Frank Co.)	Distributes auto parts
2/10/2004	Monro Muffler Brake Inc.	Mr. Tire Division (Mile One Automotive)	Tire and automotive repair stations
2/9/2004	General Parts Inc.	Automotive Communications Link Inc.	Provides business management software used by automotive repair companies and parts distributors.
2/9/2004	Graham Partners	Dynojet Research Inc.	Makes engine-performance products and diagnostic equipment
2/3/2004	Standard Motor Products	Dana's Canadian Engine Management Business	Manufactures engine and related parts
1/30/2004	Theodore Bargman Company	Heartland Industrial Partners	Manufactures lighting, electrical accessories, access doors, locks and latches for RVs
1/28/2004	LKQ Corp.	Metro East Salvage Inc.	Provider of recycled OEM replacement parts
1/13/2004	Keystone Automotive Industries	Quinte Bumper & Fender	Distributor of automobile collision replacement parts
1/12/2004	Universal Automotive Industries	Kelsey-Hayes Company	Manufactures brake disc pads and shoes and remanufactures premium brake calipers
1/6/2004	Advanced Engine Management	DC Sports Inc.	Manufactures specialty performance parts
12/22/2003	Champion Parts, Inc.	Beacon Sales & Distribution	Distributes air conditioning accumulators and driers
12/9/2003	Keystone Automotive Industries	Sam's Bumper Service	Distributes recycled bumpers
12/9/2003	QA1 Precision Products, Inc.	Carrera Shocks	Manufactures performance shocks
12/3/2003	The Harbour Group	Master Concepts	Manufactures auxiliary braking systems
1/2/2004	The Riverside Company	Harmon AutoGlass	Retail auto replacement glass business
10/31/2003	Carroll Shelby International, Inc.	Allen Engine Development Inc.	Manufactures and develops auto superchargers
10/8/2003	The Riverside Company	Stylin' Concepts Corp.	Supplies accessories for SUVs and trucks
10/1/2003	Dover Resources	Warn Industries	Manufactures winches for light trucks and all-terrain vehicles
9/22/2003	TBC Corporation	National Tire & Battery	Retailer of tires

BUSINESS VALUATION 101: WHAT'S YOUR BUSINESS WORTH?

Business valuation is best understood within the context of an M&A transaction because what someone is willing to pay for a business is usually the most practical and reliable indication of its value.

When it comes to buying businesses, buyers typically take the perspective that they are buying the cash flow a business generates. This cash flow is measured via several benchmarks, beginning with EBIT (earning before interest and taxes), the measurement which best represents the cash flow "reward" to an owner from the company's day-to-day operations. Next, depreciation and amortization are added to EBIT because they are non-cash expenses. The end result, of course, is EBITDA, the most commonly used and widely accepted proxy for cash flow in the context of business valuation.

EBITDA must be "normalized" before it can be used for valuation purposes. When calculating a company's normalized EBITDA, there are certain items that need to be added or subtracted in order to capture the "true" cash flow a business generates. Examples of items that should be added back to EBITDA include :

- Extraordinary, non-recurring, non-operating or non-business expenses such as moving expenses, litigation, conversion from FIFO to LIFO, fire losses, and theft.
- Owner's salary in excess of the market rate of compensation.
- Shareholder perks like life insurance, bonuses, cars, financial counseling, excess travel and entertainment, and any other expense that will disappear after the sale of the company.

Because buyers buy the future cash flow of a business rather than the cash flow that was generated in the past, a capitalization multiple must be applied to a business's normalized EBITDA in order to determine the present value of all its future anticipated cash flow.

Capitalization multiples approximate the present value of all the future cash flow of a business by discounting them into today's dollars using a buyer's cost of capital, which is also called the "discount rate."

A capitalization multiple is the mathematical inverse of its discount rate. For example, a 20% discount rate implies a multiple of five because its inverse, one divided by 0.20, equals five.

Multiplying normalized EBITDA by a relevant capitalization multiple yields what is known as "enterprise

value." Subtracting the company's debt from this enterprise value and adding the company's cash balances yields the market value of the shareholders' equity.

EBITDA multiples vary significantly depending on a variety of market-, industry-, and company-specific factors. Core ranges of EBITDA multiples for automotive aftermarket businesses are between four and six, but can be as much as eight or more. Some of the more important company specific valuation criteria are:

- Revenue levels;
- Amount and sustainability of Gross Margins;
- Number and type of distribution channels;
- Growth potential;
- Management strength;
- Brand equity; and
- Competition.

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

Company	Enterprise Value					Last Twelve Months (LTM)			
	Price as of 3/13/04	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	Net Income
Manufacturers									
Dana Corporation	\$20.16	\$2,996.1	\$3,237.0	\$636.0	\$5,616.6	9/30/03	\$9,774.0	\$784.0	\$219.9
Tenneco Automotive Inc.	13.40	547.0	1,404.0	63.0	1,943.6	9/30/03	3,679.0	329.0	39.2
Decoma International Inc.	8.92	744.9	335.1	93.5	1,065.7	12/31/03	2,355.8	264.9	91.7
Standard Motor Products, Inc.	14.94	294.7	242.1	17.0	521.8	9/30/03	624.2	40.1	(0.3)
Aftermarket Technology Corp.	15.09	365.4	149.5	73.5	449.9	9/30/03	382.8	71.2	33.9
R&B, Inc.	18.80	164.7	44.3	16.3	205.5	9/27/03	221.6	28.2	13.0
Transpro, Inc.	5.00	35.5	53.6	0.4	89.2	11/3/03	227.8	6.2	(2.2)
Edelbrock Corporation	13.40	73.1	0.2	4.7	69.8	12/25/03	117.7	9.5	2.6
Motorcar Parts of America, Inc.	7.50	60.6	4.9	9.6	60.5	12/31/03	153.7	8.8	7.6
Universal Automotive Industries, Inc.	1.31	11.2	15.9	0.1	29.8	9/30/03	61.6	0.2	(1.9)
Wholesalers & Distributors									
Genuine Parts Company	\$33.60	\$5,845.3	\$701.7	\$31.5	\$6,599.5	9/30/03	\$8,357.5	\$657.5	\$357.3
TBC Corporation	28.45	620.4	183.9	4.6	844.3	9/30/03	1,225.6	72.7	32.0
Keystone Automotive Industries, Inc.	26.98	409.8	21.6	3.1	451.9	12/26/03	483.8	30.3	16.3
LKQ Corporation	18.24	354.6	49.1	1.5	432.8	9/30/03	314.9	30.4	13.8
The Coast Distribution System, Inc.	6.50	29.2	20.0	1.7	49.6	9/30/03	154.2	5.7	2.6
Retailers									
Autozone, Inc.	\$83.02	\$7,244.7	\$1,453.3	\$6.7	\$9,039.2	11/22/03	\$5,520.5	\$1,049.7	\$531.4
Advance Auto Parts, Inc.	39.86	2,942.5	480.3	49.9	3,406.7	10/4/03	3,424.4	400.3	144.8
O'Reilly Automotive, Inc.	38.20	2,073.5	110.6	33.0	2,203.8	9/30/03	1,459.0	196.5	94.9
The Pep Boys - Manny, Moe & Jack	24.15	1,273.4	534.1	33.8	1,985.5	11/1/03	2,145.5	98.9	(8.1)
CSK Auto Corporation	18.64	865.8	507.1	46.9	1,349.0	11/2/03	1,555.5	161.0	42.1

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
Manufacturers									
Dana Corporation	0.6x	15.1x	7.2x	12.7x	25.5x	13.6	11.6%	8.0%	2.3%
Tenneco Automotive Inc.	0.5x	11.5x	5.9x	10.0x	49.6x	13.9	16.1%	8.9%	1.1%
Decoma International Inc.	0.5x	6.1x	4.0x	6.5x	11.6x	8.1	15.9%	11.2%	3.9%
Standard Motor Products, Inc.	0.8x	22.6x	13.0x	16.3x	NM	NM	26.5%	6.4%	NM
Aftermarket Technology Corp.	1.2x	7.7x	6.3x	7.8x	13.3x	10.8	30.0%	18.6%	8.8%
R&B, Inc.	0.9x	8.7x	7.3x	8.6x	15.9x	12.7	36.9%	12.7%	5.8%
Transpro, Inc.	0.4x	NM	14.5x	47.7x	NM	NM	15.9%	2.7%	NM
Edelbrock Corporation	0.6x	18.7x	7.3x	14.6x	26.9x	28.2	35.5%	8.1%	2.2%
Motorcar Parts of America, Inc.	0.4x	9.4x	6.9x	8.5x	8.0x	8.0	12.0%	5.7%	4.9%
Universal Automotive Industries, Inc.	0.5x	NM	NM	NM	NM	NM	13.3%	0.3%	NM
Mean	0.6x	12.5x	8.0x	14.7x	21.5x	13.6x	21.4%	8.3%	4.1%
Median	0.6x	10.4x	7.2x	10.0x	15.9x	12.7x	16.0%	8.1%	3.9%
Wholesalers & Distributors									
Genuine Parts Company	0.8x	11.2x	10.0x	11.5x	18.5x	16.4	31.1%	7.9%	4.3%
TBC Corporation	0.7x	14.9x	11.6x	15.5x	26.4x	19.4	31.0%	5.9%	2.6%
Keystone Automotive Industries, Inc.	0.9x	18.0x	14.9x	23.3x	27.7x	25.1	43.6%	6.3%	3.4%
LKQ Corporation	1.4x	17.4x	14.3x	19.6x	31.5x	25.8	45.1%	9.6%	4.4%
The Coast Distribution System, Inc.	0.3x	10.4x	8.7x	9.8x	19.3x	11.4	17.3%	3.7%	1.7%
Mean	0.8x	14.4x	11.9x	15.9x	24.7x	19.6x	33.6%	6.7%	3.3%
Median	0.8x	14.9x	11.6x	15.5x	26.4x	19.4x	31.1%	6.3%	3.4%
Retailers									
Autozone, Inc.	1.6x	9.6x	8.6x	10.4x	17.0x	13.6	46.7%	19.0%	9.6%
Advance Auto Parts, Inc.	1.0x	12.0x	8.5x	11.3x	23.5x	20.3	45.3%	11.7%	4.2%
O'Reilly Automotive, Inc.	1.5x	14.0x	11.2x	33.0x	23.2x	21.9	42.0%	13.5%	6.5%
The Pep Boys - Manny, Moe & Jack	0.9x	81.6x	20.1x	44.0x	NM	NM	27.4%	4.6%	NM
CSK Auto Corporation	0.9x	11.1x	8.4x	9.2x	32.1x	20.6	47.1%	10.4%	2.7%
Mean	1.2x	25.6x	11.4x	21.6x	24.0x	19.1x	41.7%	11.8%	5.8%
Median	1.0x	12.0x	8.6x	11.3x	23.4x	20.5x	45.3%	11.7%	5.4%

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

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful

COST ACCOUNTING 201

In the last issue, we talked about what cost accounting is and why it is important in the context of operating a business. In this segment, we will continue to discuss the practical relevance of cost accounting and more specifically, target costing.

Historically, the typical U.S. product development approach has been to (1) design the product, (2) calculate the cost, (3) set the price. If management and the marketing department think that the price and cost are too high, the product design and engineering process will be repeated until an acceptable cost is reached, after which time production will begin.

Although this "cost-plus" process seems practical and logical, it is backward.

Unfortunately, customers do not feel obliged to ensure that manufacturers receive a profit. Therefore, the only sensible way to price is to begin with what the market will bear for a given product.

Target costing rethinks the cost-plus philosophy that dominated the manufacturing world in the past. First adopted in the highly competitive assembly-oriented manufacturing environment in Japan in the early 1970s, target costing determines the maximum allowable cost for an identifiable, proposed product assuming a given target profit margin. As a result, costs are dependent on selling prices rather than vice-versa and must be justified in order to eliminate those that are unnecessary without

compromising the product quality. Broadly speaking, a target costing system has two objectives:

1) To lower the costs of new products so that the required profit level can be ensured while the new products meet the levels of quality, delivery timing and price required by the market.

2) To motivate all company employees to achieve the target profit during new product development by making target costing a company wide profit management activity.

From a cost viewpoint, the development stage is one that is given little attention by the traditional financial accounting model. For example, GAAP requires that development costs be expensed as incurred.

However, this treatment is not ideal in providing the company with a realistic estimate of a product's total life cycle costs, because numerous studies have revealed that decisions made during the development stage determine about 80% to 90% of a product's total life cycle costs. That is to say, the product design and engineering processes made during the development generally affect production costs for the rest of the product's life.

Cost accounting methods such as target costing require the cooperation of many employees, but raise efficiency levels by devising cost savings with shorter lead times.

California (Continued from page 1)

boasts 200 automotive-related businesses, 114 industry suppliers, and over 31,000 workers. During the 1990 to 2001 period, South Carolina's automotive cluster achieved a nation-leading 12.69% employment growth rate. This far exceeded the growth experienced by the second and third faster growing states, Alabama and Ohio, which grew at 9.39% and 5.12%, respectively.

Furthermore, BMW recently invested an additional \$400 million in its Spartanburg, SC plant and increased employment to nearly 5,000 workers. This investment includes a partnership with the South Carolina Department of Commerce, Clemson University, Michelin, IBM, and Microsoft to establish the International Center for Automotive Research.

Announced in November of 2003, the center is being built on 400 acres of property that fronts Interstate 85 halfway between Charlotte, NC and Atlanta, GA, a corridor that is home to 2/3 of the nation's motorsports racing teams.

Other factors making South Carolina a desirable manufacturing location include the following:

- Right-to-work state with a 1.8% unionization rate, the lowest in the nation;
- Lowest electric rates in the Southeast at \$0.37 per kilowatt hour;
- Highly competitive manufacturing wage of \$10.96
- No state property tax; no local income tax; no inventory tax; no sales tax on manufacturing machinery, industrial power, or materials for finished products; no value-added tax; no commercial occupancy taxes; no wholesale tax; and no unitary tax on worldwide profits;
- Good transportation infrastructure: seaports, highways, and railways;
- Responsive, high quality tech colleges;
- High quality of life; and
- Close proximity to North Carolina based NASCAR.

Divest (Continued from page 1)

they want to make returns on their investments.

4. **Deals close fast**—Financial buyers are geared to complete their transactions swiftly and efficiently. In situations where the seller needs to wrap up a divestiture inside a quarter-end deadline, equity firms can beat the clock. Most corporate buyers move at a pace that is more deliberate.

The current environment also looks positive for managers and employees of potential spin-offs and buyouts. Most don't have to fear a shutdown when financial buyers come in because equity firms need the company to grow and the people to grow it. Instead, they generally offer the spin-off's managers and employees opportunities to build some equity of their own. Secondly, shareholder value gets a bigger boost. Several studies show that the returns from buy-out investments are greater than those for shareholders of strategic acquirers.

The last factor is one that isn't immediately obvious to

most potential sellers. Think about a spin-off from the standpoint of the new managers: they must build a business infrastructure from scratch, setting up bank accounts, leasing buildings and equipment, hiring a law firm, and so on. If they can tap into the business contacts, financial network, and strategic counsel of a financial partner right away, they're off to a great start.

Done right, divestitures can add value both to the seller and to the spin-off. The development officers who make the most of important changes on the buyer side will be the ones who help build value on both sides of the deal.

This article was written by Bruce R. Evans. Mr. Evans is a Managing Partner of Summit Partners, a leading private equity firm that invests in growing, profitable, privately held companies with proven business models, records of revenue and earnings growth and the leadership capable of sustaining that growth. Bruce can be contacted at 617.824.1020 or bevans@summitpartners.com.