

# the aftermarket analyst

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

## What's Hot and What's Not In the Auto Aftermarket

### What's Hot

Although the auto aftermarket overall continues to be an excellent place to invest, some segments currently have more compelling investment characteristics than others. These attractive segments include truck accessories, racing/performance, and wholesalers, all of which are benefiting from favorable demographics, growth, and buyer demand.

Despite recent jitters about high oil prices and their impact on truck sales, demand for truck accessories sold through traditional aftermarket channels is expected to remain strong. US sales of light trucks have surpassed sales of cars for the last several years, and a proliferation of new models has expanded the size of this market significantly.

Furthermore, with the average price of new vehicles and the average age of vehicles on the road increasing, owners will increasingly seek aftermarket products to spruce up their vehicles.

All of these trends have created a firestorm of buyer interest. The number of truck accessory deals completed in the last twelve months (LTM) has surged by more than five times year-over-year.

NASCAR's success and the burgeoning hobbyist culture surrounding racing and performance reflect the growth and demand in this segment. Television ratings for NASCAR climbed again last year and have more than doubled since

*(Continued on page 3, See "What's Not")*

## Hedge Funds Morph Into Private Equity Players

Capital in-flows to hedge funds have reached unprecedented levels in recent years. Mesmerized by their sophisticated trading strategies and mystique, high net worth and institutional investors have poured approximately \$600 billion into these funds since 2001 — causing their assets to swell to approximately \$1 trillion today.

This glut of capital and lackluster public market returns have pushed many hedge funds to seek alternative investment classes like private equity, where returns have been robust recently. According to Cambridge Associates, a large investment consultancy, private equity returns averaged 23.5 percent in the past year.

The resurgence of hedge funds into private equity has served to intensify the competition for deals. For example, the recent battle for Toys 'R' Us pitted an investment group which included hedge fund Cerberus Capital Management LP against a number of private equity bidders, including veteran buyout house Kohlberg Kravis Roberts & Co.

This trend has also evinced itself in the auto aftermarket. ValueAct Capital's April purchase of MSD Ignition marked the first hedge fund-led buyout of an aftermarket company.

Traditional private equity firms can't be too excited about this development since many believe it will increase purchase prices and drive returns down. Furthermore, many in the private equity community echo the feelings of KKR founder and buyout legend, Henry Kravis, who recently stated in an investor conference that hedge funds don't have the right

*(Continued on page 3, See "Hedge Funds")*

## in this issue

Recently Announced Transactions.....	2
Public Company Valuations.....	4

## RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS

Announce Date	Acquirer/Investor	Target	Target Description
6/15/2005	Allied Capital Corp.	Meineke Car Care Centers	Automotive repair and service outlets
6/9/2005	Industrial Enterprises of America, Inc.	Unifide Industries LLC	Marketer and seller of automotive chemicals and additives
6/9/2005	J.B. Poindexter & Company Inc.	Federal Coach LLC	Manufacturer and marketer of funeral coaches, limousines and midsized buses
6/9/2005	World Imports International	Liteglow Industries	Manufacturer of neon and Lighting products
6/9/2005	Thule Group (Candover Investments)	Omnister Accessories NV	Belgium-based supplier of European aftermarket accessories for recreational vehicles
5/31/2005	Leonard Green & Partners LP	The Tire Rack	Mail-order and online tire retailer
5/23/2005	Keystone Automotive Operations, Inc.	Blacksmith Distributing, Inc.	Automotive aftermarket accessory distributor
5/14/2005	Fred Jones Enterprises	Global Parts Distribution	Distributor of automotive air conditioning parts to the aftermarket
5/4/2005	Valvoline, a division of Ashland Inc.	Car Brite	Distributor of interior and exterior cleaners, paint restorers and protectants and final detail dressings, paints and dyes
5/2/2005	O'Reilly Automotive, Inc.	Midwest Auto Parts Distributors, Inc.	Operates 71 auto parts stores
5/1/2005	Signal Ventures, Inc.	Flex-Trax, Inc.	Manufactures GoClaws(TM), a tire accessory product designed for both highway and off-road
4/26/2005	Allied Capital Corp.	Service Champ Inc.	Wholesale distributor of parts and equipment to the quick lube industry
4/24/2005	Wesmac LLC	QSP Automotive, Inc.	Manufacturer of chassis parts for the aftermarket
4/24/2005	Undisclosed	Four of Genuine Parts Company's Johnson Industries locations	Distributor of OEM and aftermarket parts, equipment, supplies, and facility services
4/20/2005	AirPro Mobile Air L.L.C. (Management team)	AirPro	Distributor of motor vehicle air conditioning parts and systems
4/18/2005	ValueAct Capital	MSD Ignition	Manufactures high-performance automotive ignition components
4/18/2005	Penda Corp's Glasstite manufacturing operations	Brand FX Body Company	Manufacturer of fiberglass truck caps and tonneau covers
4/12/2005	Hopkins Manufacturing Company (Friend Skoler & Co.)	Carrand Companies, Inc.	Designer and marketer of specialty cleaning tools and accessories for the automotive aftermarket
4/5/2005	Thule	Quick-load Bike Racks division of Sportworks	Manufacturer of bicycle racks

*(What's Not, Continued from page 1)*

2001. Demographic surveys show that 75 million Americans have some interest in stock car racing, with women accounting for 40 percent of the total.

Baby boomers, now in their peak earning and consumption years as they turn age 50 at a rate of 10,000 per day, are being driven by nostalgic interest in muscle cars and are participating in recreational drag racing and circle track events at ever increasing rates. Aftermarket investors are beginning to home in on this niche. The number of racing and performance deals completed in the LTM period has increased by 50 percent year-over-year.

Aftermarket wholesalers and retailers are now changing hands at higher rates than ever before. In fact, LTM transaction volume is up 31 percent year-over-year. These include several large, high profile deals such as Keystone Automotive Operations' purchase of Blacksmith Distributing, O'Reilly's purchase of Midwest, and Investcorp's recapitalization of American Tire Distributors.

### **What's Not**

Some aftermarket segments currently have decidedly unfavorable investment characteristics. These segments include sport compact product manufacturers and OE suppliers.

After furious growth up to 2003, the sport compact products segment has come upon hard times. Many of the big names in this niche have been hit by massive returns from big box retailers and automotive chain stores — placing them on precarious financial footing.

Consequently, manufacturers have not had the capital to invest in new product development, and sales have foundered. In addition, a number of bankruptcies litter the landscape. A serious infusion of fresh investment capital and more realistic customer terms will be required to put this segment on the road to recovery.

It is no secret that OE suppliers are hurting — just ask newly bankrupt Collins & Aikman. Unfortunately, there is no indication that things will improve for these beleaguered companies any time soon.

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### **About Capstone**

Capstone Financial Group is an investment banking firm assisting 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).

*(Hedge Funds, Continued from page 1)*

skills and experience to successfully turnaround or build private companies.

However, hedge funds have competitive advantages over their private equity brethren that help make it easier for them to get deals done, including:

- Lower cost of capital;
- Ability to lever their own capital;
- Ability to put capital to work more quickly than traditional private equity groups;
- One-stop-shop capability, which allows them to be more active at all layers of the capital structure, including mezzanine, second lien, equity, high yield and distressed;
- Less strenuous criteria for the companies they back — as long as they see it as interesting and can see upside, they will do the deal;
- Little regulation; and
- Higher fees.

Interestingly enough, for these reasons and others, a number of private equity funds are moving into the hedge fund business. For example, private equity titans Texas Pacific Group, Blackstone, Bain, and the Carlyle Group have all launched their own hedge funds recently.

Although these developments indicate a clear trend towards private equity and hedge fund convergence, only time will tell how it will all play out.

What seems most certain is that private business owners will be the main benefactors of this trend. With hedge funds piling into increasingly competitive private equity markets, it is likely that capital for growth, acquisitions, and shareholder liquidity will continue to be cheap and plentiful.

As the trend continues, aftermarket business owners have a real opportunity to capitalize on hedge funds' foray into private equity investing.

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

Company	Enterprise Value					Last Twelve Months (LTM)			
	Price as of 6/22/05	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	Net Income
<b>Manufacturers</b>									
Tenneco Automotive Inc.	\$16.75	\$730.4	\$1,408.0	\$68.0	\$2,141.7	3/31/05	\$4,281.0	\$361.0	\$22.6
Standard Motor Products, Inc.	12.91	256.1	351.1	8.8	598.9	3/31/05	951.3	41.7	8.2
Aftermarket Technology Corp.	16.85	359.0	107.3	9.2	462.6	3/31/05	404.5	65.7	30.5
R&B, Inc.	14.38	257.8	34.8	5.6	290.8	3/26/05	254.8	34.5	17.2
Transpro, Inc.	6.54	46.5	37.9	0.4	85.4	3/31/05	267.0	14.5	4.4
<b>Wholesalers &amp; Distributors</b>									
Genuine Parts Company	\$42.76	\$7,459.5	\$500.9	\$157.8	\$7,923.4	3/31/05	\$9,242.5	\$708.8	\$402.0
TBC Corporation	27.91	626.4	265.7	1.4	921.2	3/31/05	1,887.9	101.3	38.3
LKQ Corporation	27.23	564.5	59.1	4.2	682.0	3/31/05	458.5	46.8	23.3
Keystone Automotive Industries, Inc.	25.54	404.6	0.0	4.1	408.3	4/1/05	557.7	29.2	14.3
The Coast Distribution System, Inc.	5.15	24.1	33.6	0.3	58.3	3/31/05	173.0	8.7	3.9
<b>Retailers</b>									
Autozone, Inc.	\$93.22	\$7,199.9	\$1,914.5	\$77.4	\$9,449.0	5/7/05	\$5,664.4	\$1,119.0	\$573.8
Advance Auto Parts, Inc.	65.03	4,658.4	483.7	131.7	5,193.4	4/23/05	3,905.7	468.6	207.2
O'Reilly Automotive, Inc.	29.46	3,276.2	100.8	89.3	3,287.7	3/31/05	1,784.2	254.3	123.6
The Pep Boys - Manny, Moe & Jack	13.69	757.9	504.2	84.3	1,179.2	4/30/05	2,271.0	122.4	8.2
CSK Auto Corporation	16.96	765.9	495.7	97.7	1,176.7	5/1/05	1,577.6	127.3	34.1

**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
<b>Manufacturers</b>									
Tenneco Automotive Inc.	0.5x	11.7x	5.9x	9.6x	94.7x	32.3	15.7%	8.4%	0.5%
Standard Motor Products, Inc.	0.6x	27.9x	14.4x	18.7x	73.1x	31.2	23.6%	4.4%	0.9%
Aftermarket Technology Corp.	1.1x	8.9x	7.0x	8.2x	15.2x	11.8	25.7%	16.3%	7.5%
R&B, Inc.	1.1x	9.8x	8.4x	13.6x	16.9x	15.0	37.1%	13.6%	6.8%
Transpro, Inc.	0.3x	9.9x	5.9x	11.0x	19.2x	10.4	19.8%	5.4%	1.7%
<b>Mean</b>	<b>0.7x</b>	<b>13.6x</b>	<b>8.3x</b>	<b>12.2x</b>	<b>43.8x</b>	<b>20.2x</b>	<b>24.4%</b>	<b>9.6%</b>	<b>3.5%</b>
<b>Median</b>	<b>0.6x</b>	<b>9.9x</b>	<b>7.0x</b>	<b>11.0x</b>	<b>19.2x</b>	<b>15.0x</b>	<b>23.6%</b>	<b>8.4%</b>	<b>1.7%</b>
<b>Wholesalers &amp; Distributors</b>									
Genuine Parts Company	0.9x	12.3x	11.2x	12.6x	19.7x	18.6	31.2%	7.7%	4.3%
TBC Corporation	0.5x	12.5x	9.1x	9.0x	24.0x	16.4	37.4%	5.4%	2.0%
LKQ Corporation	1.5x	17.3x	14.6x	27.4x	29.2x	24.2	44.9%	10.2%	5.1%
Keystone Automotive Industries, Inc.	0.7x	19.5x	14.0x	19.6x	28.6x	28.4	43.6%	5.2%	2.6%
The Coast Distribution System, Inc.	0.3x	7.5x	6.7x	7.2x	14.9x	6.1	18.9%	5.0%	2.3%
<b>Mean</b>	<b>0.8x</b>	<b>13.8x</b>	<b>11.1x</b>	<b>15.2x</b>	<b>23.3x</b>	<b>18.7x</b>	<b>35.2%</b>	<b>6.7%</b>	<b>3.3%</b>
<b>Median</b>	<b>0.7x</b>	<b>12.5x</b>	<b>11.2x</b>	<b>12.6x</b>	<b>24.0x</b>	<b>18.6x</b>	<b>37.4%</b>	<b>5.4%</b>	<b>2.6%</b>
<b>Retailers</b>									
Autozone, Inc.	1.7x	9.6x	8.4x	11.0x	16.5x	12.5	49.1%	19.8%	10.1%
Advance Auto Parts, Inc.	1.3x	14.5x	11.1x	19.9x	25.1x	22.5	46.9%	12.0%	5.3%
O'Reilly Automotive, Inc.	1.8x	16.4x	12.9x	43.6x	26.6x	26.5	43.1%	14.3%	6.9%
The Pep Boys - Manny, Moe & Jack	0.5x	25.7x	9.6x	52.1x	143.8x	92.4	26.4%	5.4%	0.4%
CSK Auto Corporation	0.7x	13.0x	9.2x	11.8x	34.5x	22.5	46.0%	8.1%	2.2%
<b>Mean</b>	<b>1.2x</b>	<b>15.8x</b>	<b>10.3x</b>	<b>27.7x</b>	<b>49.3x</b>	<b>35.3x</b>	<b>42.3%</b>	<b>11.9%</b>	<b>5.0%</b>
<b>Median</b>	<b>1.3x</b>	<b>14.5x</b>	<b>9.6x</b>	<b>19.9x</b>	<b>26.6x</b>	<b>22.5x</b>	<b>46.0%</b>	<b>12.0%</b>	<b>5.3%</b>

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

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful



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Join other CFOs, financial service providers, investment analysts, CPA firms and others with interests in the automotive aftermarket for such opportunities as:

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- Perspectives on Key Financial Issues from the Accounting Side
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- View From Wall Street

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- The Financial Benefits of Standards-Based eBusiness in the Aftermarket
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