



# AFTERMARKET ANALYST

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

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The surest way to establish your credit is to work yourself into the position of not needing any.

- Maurice Switzer

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## IS IT TIME TO BUY OE SUPPLIERS?

Automotive original equipment suppliers have been out of favor in the investment community for a number of years now. And for good reason. OE suppliers have long been difficult businesses to operate. However, recent developments might make these companies attractive investments once more.

Being an OE supplier these days is as challenging as ever. Any supplier will tell you that it takes a tremendous amount of conviction, handholding, flexibility, and investment of time and resources.

Some of the things

OEMs demand from their suppliers before they will give them orders include:

- Letters of commitment stating that failure evaluation mode analysis has been performed;
- Sophisticated electronic data interchange systems;
- Same-day order fulfillment and direct shipping capability;
- Strong testing and analysis capability to comply with demanding engineering and design specifications; and
- Product quality to match the rest of the vehicle and its warranties.

Understandably, the return on investment for implementing these systems and guidelines might not come for several years. In the meantime, to ensure that suppliers meet these rigorous demands, OEMs use a powerful supplier rating system that allows any person at any point in the line to post feedback on the suppliers.

Accordingly, anyone from the OEM's design engineer to its shipping personnel can negatively impact a supplier's rating to the point where they may be barred from bidding on future OE business.

*(Continued on page 3, see "Suppliers")*

## HOPPY FLIPPED IN SECONDARY BUYOUT

Hopkins Manufacturing (Hoppy) seems to be a favorite among private equity groups these days. After being purchased by the Harbour Group in February of 1997, Hoppy was flipped to Friend Skoler & Co. late last month in a secondary buyout of the company.

Hoppy, a Kansas-based manufacturer of specialty towing products and functional accessories for the automotive and recreational vehicle aftermarkets, possesses many of the characteristics private equity investors

crave, including:

- Leading market shares within each of its product segments;
- Strong management team with a proven record of success;
- Long standing customer relationships;
- Diversified customer base; and
- Excellent positioning for future organic growth.

Alex Friend, Managing Partner of Friend Skoler, pointed out some of Hoppy's other virtues as an investment vehicle. For example, he believes the company is ideally suited

as a platform company because of its strong infrastructure and supply chain.

Furthermore, he is especially impressed with Hoppy's President, Brad Kraft, and his ability to achieve significant growth in sales and profitability. Finally, Mr. Friend likes the automotive aftermarket economics in general, which he considers to be "fairly non-cyclical."

Although transaction terms were not disclosed, several sources said Friend Skoler paid about

*(Continued on page 3, see "Hoppy")*

## RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS

Announce Date	Acquirer/Investor	Target	Target Description
8/16/2004	Valley Industries (Castle Harlan)	MME Wiring Products	Designer and manufacturer of towing wiring products
7/27/2004	Friend Skoler & Co., LLC	Hopkins Manufacturing	manufacturer of specialized towing products and functional accessories for the automotive and recreational vehicle aftermarkets
7/22/2004	SPX Corp.	Actron Manufacturing Co.	Manufacturer of automotive test equipment and instrumentation
7/12/2004	Michael DeHaas	KC Hilites	Manufactures fog, driving, and high-powered off-road lighting and related equipment
7/8/2004	The Cypress Group	Dana's Automotive Aftermarket Group	Manufactures replacement auto parts
7/6/2004	Lear Corporation	GHW Grote & Hartmann GmbH	Manufacturer of electrical components for the auto industry
6/25/2004	American Capital Strategies, Ltd.	Directed Electronics Inc.	Designer and marketer of consumer branded vehicle security and convenience systems
6/25/2004	Lund International, Inc.	Trenz	Manufacturer of grills and billet aluminum accessories
6/25/2004	O. Victor Edelbrock, Jr.	Edelbrock Corporation	Manufacturer and distributor of performance replacement parts for the automotive and motorcycle aftermarkets
6/21/2004	Chinese investment group called Street Glow (Hong Kong), Ltd.	Street Glow, Inc.	Manufacturer of automotive performance lighting
6/10/2004	Ron Storer	Go Rhino	Manufactures truck accessories including grill guards, side steps, tail light guards and hitch steps
6/2/2004	Hartford Group	Quest Industries	Manufacturer of automotive aftermarket accessories
5/13/2004	Corteco	Precision Automotive Industries	Supplier of bearings and seals
5/6/2004	Littelfuse, Inc.	Heinrich Industrie AG	Manufactures fuse products for the automotive aftermarket
4/30/2004	The Riverside Company	Vulsay Industries Ltd.	Packager and blender of petroleum-based products and liquid chemicals
4/30/2004	Reliable Automotive	Add-On Distributing, Inc.	Specialty automotive wholesale distributor
4/29/2004	New World Friction Corp.	Madeco, ULC d/b/a Novatek	Manufacturer of brake pads
4/29/2004	AutoPartSource, LLC	Qualitee International Limited Partnership	Manufactures undercar parts
4/21/2004	Performance Accessories	Trailmaster	Manufactures suspension lift systems for light trucks and SUVs
4/19/2004	Pickups Plus, Inc.	Automotive International's Automotive Preservation Division	Provides auto dealers with new vehicle preparation, environmental protection packages, pickup truck and SUV accessories, and detail and reconditioning products and services
4/14/2004	AutoZone, Inc.	ABC Discount Auto Parts	Retailer of auto parts
4/8/2004	Gryphon Investors, Inc.	Autotronic Controls Corporation (MSD Ignition)	Manufactures high-performance automotive ignition components

**Hoppy** (Continued from page 1)

\$140 million for Hopkins. This translates to just under seven times the company's trailing twelve months EBITDA.

At least one losing bidder on the deal posits that Friend Skoler overpaid for Hoppy. This firm said their bid of 6.5 times EBITDA showed a meager 8 percent internal rate of return (IRR) in their pricing model — well below the 20 percent to 30 percent range most private equity firms look for in such deals.

Despite this assertion, Mr. Friend maintains that he expects significantly higher returns from

Hopkins than the other bidder suggests.

Therefore, it seems more than likely that the two firms used very different assumptions when pricing the Hopkins deal. This illustrates how important earnings growth, capital structure, and financing term assumptions can be when pricing transactions.

Even small changes in IRR model assumptions can be the difference between winning and losing in a hotly contested auction.

No doubt, American Capital's layer of mezzanine financing was a critical factor in Friend Skoler's successful bid.

American Capital, which has already funded two other large aftermarket deals in the past year (Directed Electronics and ESCORT), provided \$35 million in subordinated debt and preferred stock.

Antares Capital underwrote the senior debt on the transaction along with GE Capital and CIT.

Founded in 1998, Friend Skoler has invested over \$82 million in five platform companies and eight add-on acquisitions in the lower middle market.

A newcomer to the automotive industry, the firm's prior investments include United Pet Group,

a manufacturer of premium branded pet products and aquatics equipment, and Woodstream Corporation, a manufacturer of branded household pest control, lawn and garden care, and wildlife and pet products.

Friend Skoler's investment in Hoppy was its first from the \$231 million fund that it closed in April of this year.

Mr. Friend says they will be opportunistic with acquisitions going forward. The firm will consider add-ons that are "logical extensions of the business" and those that "can leverage off [Hopkin's] structure.

**Suppliers** (Continued from page 1)

To an extent, these developments seem logical, because OEMs recognize that their fate is inextricably linked with that of their suppliers. Hence, a new business paradigm is applicable.

No longer does the "people do business with people" axiom apply to this industry. In the automotive marketplace, businesses do business with businesses. Therefore, managing OEM relationships from every relevant angle has effectively become the core competency of today's suppliers.

In sync with OEM demands, the number of suppliers has fallen precipitously in recent years. For example, not long ago there were approximately 11,000

suppliers to General Motors worldwide. Today, 98 percent of all parts on GM vehicles are made by only 65 suppliers — bad news for those that have had to exit the business, but good news for those left standing. This explains why profit margins for many of these businesses have begun to creep back up.

This elite circle of 65 suppliers is effectively the only group allowed to bid on OE projects because the supplier rating system effectively locks out new entrants. In addition, OEMs are unwilling to take the time and effort required to find and qualify new suppliers when a new project comes up for bid.

Consequently, the only way into this close knit community these days is through acquisition.

Other trends making OE suppliers more valuable include the OEMs' increasing dependence on them. The fact is, OEMs do not want to make the automobiles themselves anymore. They are leaving more and more of the manufacturing up to their suppliers.

Ideally, OEMs would simply snap complete automobile assemblies, manufactured entirely by their suppliers, together like Legos and slap their decals on the hood before shipping them off to dealers.

Another important recent trend is the OEMs' determination to sell more specialty equipment and accessories such as tonneau covers, step bars, and grill guards as original equipment. Traditionally, these types of items have been mostly aftermarket

add-ons. However, in the near future this landscape will change dramatically.

Currently, OEMs are only doing about 15 percent of the sales volume that they would like to be doing on these types of accessories. In the next five to ten years, OEMs will increase accessory sales volume by a factor of six to seven times.

Suppliers fortunate enough to be positioned for the increased business can expect compound annual growth rates of 20 percent 40 percent in these product lines.

With growth rates of this magnitude, OE suppliers will easily be commanding multiples north of eight times EBITDA, significantly higher than where they've been in the past.

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

Company	Enterprise Value					Last Twelve Months (LTM)			
	Price as of 8/17/04	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	Net Income
<b>Manufacturers</b>									
Tenneco Automotive Inc.	13.42	563.7	1,419.0	166.0	1,881.6	6/30/04	3,995.0	360.0	30.6
Decoma International Inc.	8.55	714.1	341.6	115.1	1,018.8	6/30/04	2,573.2	257.6	83.1
Standard Motor Products, Inc.	13.93	275.4	240.0	11.2	505.8	6/30/04	816.8	45.7	8.9
Aftermarket Technology Corp.	13.12	274.3	119.4	0.3	400.4	6/30/04	366.0	49.2	20.1
R&B, Inc.	20.01	177.1	43.8	17.9	216.9	6/26/04	234.0	32.9	16.2
Transpro, Inc.	5.92	42.1	50.7	0.3	93.4	6/30/04	249.8	11.6	0.9
Motorcar Parts of America, Inc.	8.35	68.3	1.5	10.7	63.1	6/30/04	156.7	12.5	5.9
<b>Wholesalers &amp; Distributors</b>									
Genuine Parts Company	\$37.95	\$6,641.0	\$1,298.7	\$127.7	\$7,918.8	6/30/04	\$8,769.3	\$673.0	\$376.4
TBC Corporation	22.88	509.0	318.0	3.4	848.4	6/30/04	1,623.5	92.3	35.4
LKQ Corporation	18.37	364.5	34.4	3.7	428.9	3/31/04	348.8	34.5	16.3
Keystone Automotive Industries, Inc.	21.81	339.4	5.8	5.7	348.9	7/2/04	524.1	33.6	17.6
The Coast Distribution System, Inc.	7.31	33.7	31.9	1.5	66.4	6/30/04	169.2	8.9	4.1
<b>Retailers</b>									
Autozone, Inc.	\$77.85	\$6,472.4	\$1,798.9	\$6.8	\$8,579.9	5/8/04	\$5,630.6	\$1,099.1	\$561.2
Advance Auto Parts, Inc.	35.60	2,665.3	346.5	19.8	3,088.4	7/17/04	3,691.7	433.2	189.1
O'Reilly Automotive, Inc.	38.90	2,143.7	101.4	88.1	2,212.2	6/30/04	1,617.7	225.9	113.2
The Pep Boys - Manny, Moe & Jack	22.45	1,298.4	450.1	98.8	1,846.6	5/1/04	2,189.5	121.8	12.1
CSK Auto Corporation	12.55	584.0	508.5	43.6	1,053.1	5/2/04	1,597.7	169.9	54.3

**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	10.0x	5.2x	8.1x	61.5x	18.4	16.2%	9.0%	0.8%
Decoma International Inc.	0.4x	6.3x	4.0x	6.1x	12.3x	8.6	14.3%	10.0%	3.2%
Standard Motor Products, Inc.	0.6x	18.3x	11.1x	13.8x	56.8x	31.0	25.7%	5.6%	1.1%
Aftermarket Technology Corp.	1.1x	11.1x	8.1x	11.4x	19.9x	13.7	25.0%	13.4%	5.5%
R&B, Inc.	0.9x	7.6x	6.6x	8.9x	13.4x	10.9	37.6%	14.0%	6.9%
Transpro, Inc.	0.4x	16.8x	8.1x	17.3x	104.9x	47.2	17.8%	4.6%	0.4%
Motorcar Parts of America, Inc.	0.4x	6.2x	5.0x	5.0x	10.7x	11.6	14.5%	8.0%	3.8%
<b>Mean</b>	<b>0.6x</b>	<b>10.9x</b>	<b>6.9x</b>	<b>10.1x</b>	<b>39.9x</b>	<b>20.2x</b>	<b>21.6%</b>	<b>9.2%</b>	<b>3.1%</b>
<b>Median</b>	<b>0.5x</b>	<b>10.0x</b>	<b>6.6x</b>	<b>8.9x</b>	<b>19.9x</b>	<b>13.7x</b>	<b>17.8%</b>	<b>9.0%</b>	<b>3.2%</b>
<b>Wholesalers &amp; Distributors</b>									
Genuine Parts Company	0.9x	13.1x	11.8x	12.9x	21.0x	17.6	30.9%	7.7%	4.3%
TBC Corporation	0.5x	12.5x	9.2x	12.7x	24.0x	14.4	36.2%	5.7%	2.2%
LKQ Corporation	1.2x	14.8x	12.4x	21.3x	26.4x	22.4	45.2%	9.9%	4.7%
Keystone Automotive Industries, Inc.	0.7x	13.1x	10.4x	16.4x	19.8x	19.3	43.6%	6.4%	3.4%
The Coast Distribution System, Inc.	0.4x	8.4x	7.5x	8.0x	16.2x	8.2	18.5%	5.2%	2.4%
<b>Mean</b>	<b>0.7x</b>	<b>12.4x</b>	<b>10.3x</b>	<b>14.3x</b>	<b>21.5x</b>	<b>16.4x</b>	<b>34.9%</b>	<b>7.0%</b>	<b>3.4%</b>
<b>Median</b>	<b>0.7x</b>	<b>13.1x</b>	<b>10.4x</b>	<b>12.9x</b>	<b>21.0x</b>	<b>17.6x</b>	<b>36.2%</b>	<b>6.4%</b>	<b>3.4%</b>
<b>Retailers</b>									
Autozone, Inc.	1.5x	8.6x	7.8x	9.5x	15.3x	11.5	48.3%	19.5%	10.0%
Advance Auto Parts, Inc.	0.8x	9.4x	7.1x	10.5x	16.3x	14.1	46.2%	11.7%	5.1%
O'Reilly Automotive, Inc.	1.4x	12.1x	9.8x	29.4x	19.5x	18.9	42.6%	14.0%	7.0%
The Pep Boys - Manny, Moe & Jack	0.8x	34.6x	15.2x	23.2x	NM	107.1	27.6%	5.6%	0.6%
CSK Auto Corporation	0.7x	7.9x	6.2x	7.0x	19.4x	10.8	47.7%	10.6%	3.4%
<b>Mean</b>	<b>1.0x</b>	<b>14.5x</b>	<b>9.2x</b>	<b>15.9x</b>	<b>17.6x</b>	<b>32.5x</b>	<b>42.5%</b>	<b>12.3%</b>	<b>5.2%</b>
<b>Median</b>	<b>0.8x</b>	<b>9.4x</b>	<b>7.8x</b>	<b>10.5x</b>	<b>17.9x</b>	<b>14.1x</b>	<b>46.2%</b>	<b>11.7%</b>	<b>5.1%</b>

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

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful