

the aftermarket analyst

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

Leverage in the Middle Market

As the economy continues to show signs of weakness, we thought it would be beneficial to detail the economic effect on aftermarket M&A. The most obvious effect can be found in the debt markets which affect economic performance primarily through the availability and costs of capital. Most financial buyers (Private Equity Groups), will use debt (leverage) to finance a portion of an acquisition. In these “sponsored” deals, senior debt is usually the most cost effective form of capital available.

While deals involving companies with revenues in excess of \$500 million have been impacted by the debt markets fairly dramatically over the last 12 months , middle market deals have been relatively unscathed. For “middle market” companies, which we define as those with less than \$500 million in revenue and which are the focus of this article, the senior debt market has changed only marginally over the last 12 months. A year ago, banks would fight over the opportunity to provide 3.0x – 3.5x EBITDA of senior debt to complete a transaction. Today, a more cautious lending environment (reminiscent of 2005) prevails, with some banks restricting their borrowings within certain industries such as automotive. While readers of our newsletter may live and breath the aftermarket, many banks lump the aftermarket in with OEMs and their suppliers which have had very public struggles over the past years. For banks that are willing to lend to the aftermarket, senior debt has decreased to multiples of 2.5x – 3.0x EBITDA.

Smith Nominated for SEMA Board

Dan Smith, founder and President of Capstone Financial Group, has been nominated for the 2008 SEMA Board of Directors' election. Dan hopes to utilize his extensive industry experience as in investment banker and Ford dealer to bring a new perspective to the SEMA Board during these tumultuous times. Capstone has worked with more than 150 SEMA companies on issues regarding financing, operational improvements, growth strategies and acquisitions, all of which are important in this environment.

The following hypothetical example will help illustrate the impact this would have on a Private Equity Group's acquisition decision:

Company A does \$200 million in sales and has EBITDA of \$20 million. The acquisition price is 7.0x EBITDA or \$140 million. Last year, a financial buyer would have been able to obtain \$70 million in senior debt (3.5x EBITDA) and the remaining \$70 million would have come from equity and possibly some mezzanine financing. Today, the group can get only \$60 million (3.0x EBITDA) in senior debt and utilize \$80 million in equity and mezzanine financing. The more restrictive senior debt financing cost the sponsor an additional \$10 million out of their own coffers, resulting in a lower rate return at the same acquisition price.

The leverage component of M&A deals has not dried up, but as the table on page 3 indicates, it has retreated to the historical 2004-2005 levels.

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RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS

Announce Date	Acquirer/Investor(s)	Target	Target Description	Firm Value (\$mil.)	FV / Rev.	FV / EBITDA
4/3/2008	Haldex	Concentric	a supplier of oil, water and fuel pumps for diesel engines	\$149.0	—	—
4/1/2008	O'Reilly Automotive	CSK Auto Corp.	retailer of automotive parts and accessories with 1,332 stores in 22 western states	1,000.0	\$1,950.0	9.1x
4/1/2008	Midas	G.C. & K.B. Investments, Inc.	affiliated entities that franchise or sub-franchise 181 Speedee quick-lube and automotive maintenance shops in the United States and Mexico	—	—	—
3/31/2008	Superior Capital Partners	Rostra Precision Control	manufacturer of auto electronics and accessories for the automotive aftermarket	—	—	—
3/28/2008	Bosch	Weicon	manufacturer of diagnostic equipment and related software	—	4.7	—
3/19/2008	Pilot Automotive	Racing Sports Akimoto and DUB-Air	Racing Sports Akimoto and DUB-Air, both divisions of the Avanche Corp. Racing Sports Akimoto and DUB-Air are leaders in the sport compact and urban markets, respectively.	—	—	—
3/14/2008	Cash Technologies	Turbomotive	certain assets related to Turbomotive's turbocharger technology.	—	—	—
3/14/2008	1-800-Radiator	AAA Radiator Warehouse	San Diego, CA-based automotive cooling parts business	—	—	—
3/14/2008	Bosch	Accu Industries Inc.	company sells tire changers, wheel balancers and wheel alignment equipment	—	16.0	—
3/13/2008	Bosch	Shenzhen Wei Ning Da Industrial Co. Ltd	diagnostic equipment maker	—	—	—
3/13/2008	1-800-Radiator	Tri-US Auto Radiator	a family-owned and operated automotive cooling parts business	—	3.0	—
3/7/2008	Smith Auto Parts	Decker Auto Supply	the business has 64 employees with 30 delivery trucks operating out of one location	—	—	—
3/7/2008	Cash Technologies	Champion Parts Inc.	leading remanufacturer of automotive fuel system components.	3.2	—	—
3/4/2008	STEMCO	V.W. Kaiser Engineering	a privately-held company with 30 years of experience testing and manufacturing quality long-life pins and bushings for kingpin and suspension applications	—	—	—
3/4/2008	Gates Corp.	A.E. Hydraulic (Pte) Ltd.	a Singapore-based supplier of hydraulic and industrial hose solutions for the oil exploration industry	—	—	—
2/29/2008	Sun Capital Partners	Raytech Corp.	products for wet friction applications, primarily plates and friction material for automobile and light-truck automatic transmissions, as well as transmission filters and related components	—	—	—
2/21/2008	ATK VEGE	Orient Engine, Inc.	a remanufacturer of import engines, specializing in Japanese brands.	—	—	—
2/18/2008	Bearing Technologies, Ltd.	North Coast Bearings, Inc.	a supplier of differential and transmission rebuild kits, bearings and related components.	—	—	—

Historical Senior Debt to EBITDA and Total Debt to EBITDA

Source: GF Data Resources

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Senior Debt / EBITDA	2.2x	2.5x	2.5x	2.8x	3.1x
Total Debt / EBITDA	3.4x	3.4x	3.3x	3.8x	3.9x

The mezzanine market is very active, as senior debt becomes more restrictive, allowing mezzanine lenders a greater security interest vis-à-vis last year. Also, loan covenants are becoming more restrictive as banks keep a closer watch on the financial stability of their borrowers.

This does not mean that deals aren't getting done in a challenging aftermarket M&A environment. In fact, the first quarter of 2008 saw more aftermarket transactions (28) than the same period in 2007 (24). Today's M&A environment requires more creativity and a realistic approach to value and expected returns.

O'Reilly Automotive Acquires CSK Auto Corporation

On April 1, 2008 O'Reilly announced it had signed a definitive merger agreement with CSK Auto. Under the terms of the agreement, O'Reilly will acquire all of the outstanding shares of CSK common stock in a transaction valued at roughly \$1.0 billion, including approximately \$500 million of debt. The boards of directors of both companies have approved the transaction.

O'Reilly's purchase of CSK continues the industry's trend of consolidation and would make the combined company the third largest national auto parts retailer in the country. But more importantly, the acquisition has allowed O'Reilly to gain a ready-made entry point into the West Coast market.

"This move opens up the entire West Coast for us," says Mark Merz, a senior accountant with O'Reilly and a member of the company's investor relations team. "We're excited about expanding our DIFM operations and employing our dual-market strategy within the new stores. We see a lot of outside potential resulting from this transaction."

In addition to the size and geographic expansion, O'Reilly will benefit from focusing more on DIFM customers in the new CSK stores. The DIFM segment is attracting heavy attention from major retailers as the non-discretionary nature of most purchases is ideal for a struggling economy. O'Reilly has long been considered an industry leader in DIFM operations, as their customer mix is roughly 50% DIY and 50% DIFM. This compares favorably to CSK and the two largest competitors, AutoZone and Advance, all of which have roughly an 85% DIY and 15% DIFM customer mix.

O'Reilly has given itself the opportunity to move into the upper echelon of large automotive retailers and will now need to successfully integrate the CSK acquisition. We, like Mark Merz, see a lot of upside potential resulting from the transaction.

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.



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

Company	Enterprise Value				Last Twelve Months (LTM)				
	Price as of 3/31/08	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	Net Income
Manufacturers									
Tenneco Automotive, Inc.	\$27.94	\$1,279.9	\$1,374.0	\$188.0	\$2,538.8	12/31/07	\$6,184.0	\$461.0	(\$5.0)
Aftermarket Technology Corp.	19.44	431.0	0.0	40.1	394.4	12/31/07	530.7	79.9	40.8
Directed Electronics, Inc.	2.07	52.4	266.9	4.8	314.6	12/31/07	401.1	50.7	(21.1)
Standard Motor Products, Inc.	6.12	113.3	255.3	13.3	355.3	12/31/07	790.2	48.5	12.1
Dorman Products, Inc.	10.75	190.2	17.6	6.9	205.3	12/31/07	327.7	42.1	19.4
Wholesalers & Distributors									
Genuine Parts Company	\$40.17	\$6,640.3	\$500.0	\$231.8	\$6,988.4	12/31/07	\$10,843.2	\$925.6	\$506.3
LKQ Corporation	22.89	3,078.8	658.5	74.2	3,857.5	12/31/07	1,126.8	141.1	66.1
The Coast Distribution System, Inc.	5.10	22.6	24.8	0.8	46.6	12/31/07	164.3	3.6	0.2
Retailers									
Autozone, Inc.	\$117.23	\$7,411.3	\$2,095.0	\$93.5	\$9,518.9	2/9/08	\$6,271.3	\$1,244.0	\$608.0
Advance Auto Parts, Inc.	35.03	3,581.0	505.7	14.7	4,086.0	12/29/07	4,844.4	563.7	238.3
O'Reilly Automotive, Inc.	29.45	3,398.2	100.5	47.6	3,488.9	12/31/07	2,522.3	384.1	194.0
The Pep Boys - Manny, Moe & Jack	9.92	513.2	672.2	26.2	1,159.2	11/3/07	2,226.4	89.5	(19.2)
CSK Auto Corporation	11.40	501.1	532.1	19.9	1,013.3	8/5/07	1,908.5	130.4	21.4
US Auto Parts Network, Inc.	3.20	95.5	1.1	42.0	54.6	12/31/07	161.0	10.1	(0.8)

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									
Tenneco Automotive, Inc.	0.4x	9.9x	5.5x	8.9x	NM	NM	15.8%	7.5%	NM
Aftermarket Technology Corp.	0.7x	6.1x	4.9x	6.9x	9.7x	10.6	24.7%	15.1%	7.7%
Directed Electronics, Inc.	0.8x	7.7x	6.2x	6.6x	NM	NM	35.3%	12.6%	NM
Standard Motor Products, Inc.	0.4x	10.7x	7.3x	10.3x	29.4x	9.4	25.6%	6.1%	1.5%
Dorman Products, Inc.	0.6x	6.0x	4.9x	5.6x	10.6x	9.8	34.3%	12.9%	5.9%
Mean	0.6x	8.1x	5.8x	7.7x	16.5x	9.9x	27.1%	10.8%	5.1%
Median	0.6x	7.7x	5.5x	6.9x	10.6x	9.8x	25.6%	12.6%	5.9%
Wholesalers & Distributors									
Genuine Parts Company	0.6x	8.3x	7.6x	8.6x	13.8x	13.1	29.7%	8.5%	4.7%
LKQ Corporation	3.4x	31.4x	27.3x	37.6x	58.3x	46.6	44.9%	12.5%	5.9%
The Coast Distribution System, Inc.	0.3x	17.6x	13.1x	26.2x	NM	105.3	18.7%	2.2%	0.0
Mean	1.5x	19.1x	16.0x	24.1x	36.1x	55.0x	31.1%	7.7%	3.6%
Median	0.6x	17.6x	13.1x	26.2x	36.1x	46.6x	29.7%	8.5%	4.7%
Retailers									
Autozone, Inc.	1.5x	8.8x	7.7x	9.3x	15.7x	12.2	50.0%	19.8%	9.7%
Advance Auto Parts, Inc.	0.8x	9.8x	7.2x	11.6x	17.1x	15.0	47.9%	11.6%	4.9%
O'Reilly Automotive, Inc.	1.4x	11.4x	9.1x	34.4x	18.0x	17.5	44.4%	15.2%	7.7%
The Pep Boys - Manny, Moe & Jack	0.5x	NM	13.0x	37.5x	NM	NM	24.1%	4.0%	NM
CSK Auto Corporation	0.5x	11.4x	7.8x	11.2x	47.4x	23.4	47.1%	6.8%	1.1%
US Auto Parts Network, Inc.	0.3x	NM	5.4x	10.6x	NM	NM	33.4%	6.3%	NM
Mean	1.0x	10.4x	8.3x	20.8x	24.5x	17.0x	41.2%	10.6%	5.9%
Median	0.8x	10.6x	7.7x	11.6x	17.6x	16.3x	47.1%	11.6%	6.3%

(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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