

# the aftermarket analyst

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

## Specialty Equipment Distribution: The Times They Are A-Changin'

*"Just for a second there, I thought I saw something move" -  
Bob Dylan*

Bob was right. Things are moving big-time in the distribution of automotive specialty equipment. These products, unlike repair and replacement parts, are purchased out of want rather than need. Over the past 10 years, this \$36.7 billion segment of the aftermarket has experienced a 7.4% annual growth rate versus 4.5% of the total automotive aftermarket. As this segment continues to mature, power is shifting from traditional warehouse distributors (WDs) to specialty distributors and, in many cases, back into the hands of the manufacturers.

Over the past several years, we have written newsletter articles forecasting the coming shake-up in aftermarket distribution channels. In our July 2004 article, "They Do It Because They Can," we pointed out how the use of oppressive policies by some WDs was leading manufacturers to seek out new distribution channels which bypassed these WDs. Our May 2006 newsletter featured the article "A Real Manufacturing Roll-up: Is it Time?" which explored the price pressures that manufacturers were facing in light of increased Asian competition and their subsequent efforts to shorten the traditional three-step distribution method to a two-step method and, in some cases, a one-step method selling direct to the consumer. It is our belief that the speed of this shift away from three-step distribution is greatly accelerating, especially for the WDs that don't specialize or offer value added services along the chain. Savvy consumers, increasing competition,

## Capstone Distribution Survey

As part of our analysis of the revolution in aftermarket distribution, we are conducting an online survey to gather opinions from industry executives. To participate in this survey (in complete confidence), please visit our home page at [www.capfg.com](http://www.capfg.com) and click on the link "Click here to take our June 2007 auto aftermarket survey."

Results will be published in next month's newsletter.

and heavy handed tactics by some WDs are causing a dramatic shift away from the status quo.

**Savvy consumers** – The internet has not only changed the way Do-it-Yourselfers (DIY) purchase their automotive specialty equipment products, but also the way installers in the Do-it-for-Me (DIFM) channel make their purchasing decisions. The world has become much more transparent to both of these consumer types and with this transparency becomes more options. Even if purchases aren't made online, the internet provides a wealth of information about pricing which can then be used with a company's current supplier. Importantly, consumers will find a way to buy products via the method which provides the lowest cost and least hassle. As Thomas L. Friedman said in his bestseller, *The World Is Flat*, " . . . Globalization 3.0 (that which has occurred since 2000) differs from the previous eras . . . in how it is empowering individuals." This empowerment is being played out extensively in the auto aftermarket.

**Increasing Competition** – Competition is fierce for both manufacturers and distributors of automotive specialty

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## RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS

| Announce Date | Acquirer/Investor                               | Target  | Target Description  | Firm Value (\$mil.) | Rev. FV / Rev. | EBITDA FV / EBITDA |
|---------------|---|---|---|---------------------|----------------|--------------------|
| 5/30/2007     | PTA Holdings, Inc.                              | V-Flow Fuel Maximizer, Inc.                                 | proprietary patent-pending state-of-the-art Hydrogen/Oxygen Generating Component for increasing internal combustion engines fuel efficiency   | —                   | —              | —                  |
| 5/30/2007     | Sun Capital Partners Inc.                       | Fluid-Handling Assets Of Mark IV Industries                 | produces coolant hoses, fuel lines, transmission parts and other items at six facilities in Florida, Michigan, South Carolina, Tennessee, and Quebec.   | —                   | —              | —                  |
| 5/30/2007     | HD Partners Acquisition Corporation             | National Hot Rod Association                                | the world's preeminent drag racing organization   | \$121.0             | —              | —                  |
| 5/30/2007     | Travel Centers of America                       | Petro Stopping Centers                                      | Petro operates and franchises 69 travel centers along the U.S. Interstate Highway System in 33 states. Petro owns and operates 44 travel centers, franchises 24 travel centers and operates one travel center for a joint venture that is partially owned by Petro. | 70.0                | —              | —                  |
| 5/22/2007     | Directed Electronics                            | Trilogix Electronic Systems                                 | a leader in vehicle integration solutions simplifying the installation of aftermarket remote start systems by providing innovative, software-based technology products  | —                   | —              | —                  |
| 5/17/2007     | ArvinMeritor, Inc.                              | One Equity Partners   | ArvinMeritor's Emissions Technologies business group  | 310.0               | —              | —                  |
| 5/15/2007     | Source Interlink Companies, Inc.                | PRIMEDIA Inc's Enthusiast Media Division                    | 73 magazines, including Motor Trend and Power & Motoryacht; 90 Web sites, events and a television program.  | 1,200.0             | —              | —                  |
| 5/9/2007      | Moog, Inc.                                      | Thermal Control Products Inc.                               | thermal Control Products, a Camarillo, CA company, specializes in the design, prototype and manufacture of electronic cooling and air moving systems for the automotive, telecommunications, medical, server and electronic storage markets.                        | 7.5                 | \$5.0          | —                  |
| 5/7/2007      | Hancock Park Associates                         | ASC, Inc.   | automotive sunroof manufacturer   | —                   | —              | —                  |
| 5/1/2007      | Thule   | Case Logic  | storage solutions and lifestyle accessories in both the U.S. and Europe   | —                   | —              | —                  |
| 5/1/2007      | Transtar Industries                             | Axiom Automotive  | major supplier of original equipment (OE) and aftermarket transmission replacement parts  | —                   | —              | —                  |
| 4/30/2007     | IMCO  | Tubex Manufacturing   | maker of pre-bent exhaust pipes.  | —                   | —              | —                  |
| 4/24/2007     | THK Company, Ltd                                | Rhythm Corp. (from Carlyle)                                 | designs and manufactures automotive parts   | 106.0               | —              | —                  |
| 4/20/2007     | Collins & Aikman Corp - Soft Trim Business Unit | International Automotive Components Group North America Inc | manufacturer of Automobile Flooring   | 134.0               | —              | —                  |

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equipment. China, with its inexpensive labor and government subsidies, has forced many domestic manufacturers to look for alternate means to level the playing field. One of the few places to look is through shortening the distribution chain. Increased margins and brand loyalty are two of the benefits of decreasing the steps to the consumer. There is also stiff competition at the distributor level from internet distributors. Some of the large internet distributors have entered the auto aftermarket expecting to lose money or break even on the business. These "loss leaders" are justified by higher profits from other products.

**Heavy handed tactics by WDs** – The WDs could argue that they are just passing on the tactics that many of the retailers are forcing on them, but they're excluding the human element of the business. Frankly put, if people view doing business with you as a necessary evil, your long-term sustainability is in jeopardy. Some of the smaller WDs are joining forces just to supply an alternative to those manufacturers who have tired of these tactics. Additionally, since many WDs have diversified their distribution channels, many of these smaller WDs have realized they are now buying from their competitors, thereby increasing their need for consolidation.

On the manufacturing front, domestic specialty equipment manufacturers must be careful to design and produce products for the proper channels. Specifically, many manufacturers have faltered because they primarily produce goods for the changing and diminishing WD base. Simply put, these manufacturers are developing products for the wrong channel. Worse still, these

manufacturers are facing significant rationalization (read: reduction) in the number of vendors supplying the WDs because of their survival issues. As manufacturers in the industry decide to consolidate, we're beginning to see signs of a transfer of power from the WDs to the manufacturers.

During periods of fierce competition, the status quo is usually thrown by the wayside in favor of scale or innovation. We see companies either innovating around the current distribution chain or consolidating to gain economies of scale, or both. Both innovation and scale disrupt the current three-step model and allow for a leaner distribution model that provides both increased margins and increased efficiencies. For those companies not adjusting to the industry's changes, Bob Dylan has the following warning from the same song as the line quoted above: *"Any minute now I'm expecting all hell to break loose."*

### Schedule a Meeting with Capstone

The Capstone Auto Aftermarket Team is scheduled to be at Industry Week in Las Vegas from Monday, October 29th to Friday, November 2nd, 2007.

To schedule a meeting, please contact:  
Graham Payne at [gpayne@capfg.com](mailto:gpayne@capfg.com)

### 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**  
(S in millions, except per share data)

| Company                               | Enterprise Value    |            |           |         | Enterprise Value (1) | Last Twelve Months (LTM) |            |           |            |
|---------------------------------------|---------------------|------------|-----------|---------|----------------------|--------------------------|------------|-----------|------------|
|                                       | Price as of 5/31/07 | Market Cap | Debt      | Cash    |                      | LTM Date                 | Revenue    | EBITDA    | Net Income |
| <b>Manufacturers</b>                  |                     |            |           |         |                      |                          |            |           |            |
| Tenneco Automotive Inc.               | \$32.61             | \$1,509.5  | \$1,453.0 | \$136.0 | \$2,922.8            | 3/30/07                  | \$4,952.0  | \$392.0   | \$47.0     |
| Aftermarket Technology Corp.          | 29.97               | 654.8      | 9.0       | 12.3    | 667.9                | 3/31/07                  | 510.4      | 68.3      | 31.7       |
| Directed Electronics, Inc.            | 8.87                | 223.7      | 324.5     | 14.1    | 534.0                | 3/31/07                  | 441.4      | 58.3      | 17.6       |
| Standard Motor Products, Inc.         | 15.55               | 293.6      | 361.7     | 18.3    | 638.3                | 3/31/07                  | 801.8      | 52.2      | 11.0       |
| Dorman Products, Inc.                 | 14.22               | 251.5      | 28.2      | 7.3     | 280.8                | 3/31/07                  | 301.3      | 37.7      | 16.2       |
| <b>Wholesalers &amp; Distributors</b> |                     |            |           |         |                      |                          |            |           |            |
| Genuine Parts Company                 | \$51.32             | \$8,743.8  | \$500.0   | \$250.1 | \$9,154.6            | 3/31/07                  | \$10,553.2 | \$884.8   | \$483.0    |
| LKQ Corporation                       | 24.97               | 1,335.5    | 117.0     | 5.9     | 1,565.5              | 3/31/07                  | 832.6      | 96.9      | 48.1       |
| Keystone Automotive Industries, Inc.  | 41.31               | 674.7      | 0.2       | 6.5     | 677.2                | 12/29/06                 | 693.7      | 53.9      | 26.4       |
| The Coast Distribution System, Inc.   | 6.59                | 29.1       | 42.7      | 1.0     | 71.2                 | 3/31/07                  | 171.2      | 4.8       | 1.2        |
| <b>Retailers</b>                      |                     |            |           |         |                      |                          |            |           |            |
| Autozone, Inc.                        | \$128.63            | \$9,091.1  | \$1,854.3 | \$86.1  | \$11,022.2           | 2/10/07                  | \$6,049.9  | \$1,187.0 | \$584.8    |
| Advance Auto Parts, Inc.              | 41.42               | 4,409.5    | 404.2     | 17.0    | 4,884.7              | 4/21/07                  | 4,691.6    | 556.8     | 232.7      |
| O'Reilly Automotive, Inc.             | 37.99               | 4,335.7    | 100.7     | 90.2    | 4,460.8              | 3/31/07                  | 2,360.0    | 359.7     | 186.1      |
| The Pep Boys - Manny, Moe & Jack      | 21.30               | 1,158.6    | 657.5     | 21.9    | 1,804.9              | 2/3/07                   | 2,272.2    | 109.2     | (11.3)     |
| CSK Auto Corporation                  | 18.20               | 797.4      | 395.1     | 19.3    | 1,188.5              | 10/30/05                 | 1,594.5    | 121.9     | 31.3       |
| US Auto Parts Network, Inc.           | 7.94                | 236.9      | 1.2       | 45.6    | 192.4                | 3/31/07                  | 145.8      | 10.2      | 1.0        |

**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.               | 0.6x               | 14.3x        | 7.5x         | 13.7x              | 62.2x        | 32.1         | 13.5%         | 7.9%           | 0.9%        |
| Aftermarket Technology Corp.          | 1.3x               | 12.4x        | 9.8x         | 12.6x              | 21.1x        | 20.7         | 21.7%         | 13.4%          | 6.2%        |
| Directed Electronics, Inc.            | 1.2x               | 10.5x        | 9.2x         | 9.6x               | 30.4x        | 12.7         | 29.8%         | 13.2%          | 4.0%        |
| Standard Motor Products, Inc.         | 0.8x               | 17.3x        | 12.2x        | 15.3x              | 58.1x        | 26.7         | 25.4%         | 6.5%           | 1.4%        |
| Dorman Products, Inc.                 | 0.9x               | 9.2x         | 7.5x         | 9.2x               | 17.3x        | 15.5         | 34.7%         | 12.5%          | 5.4%        |
| <b>Mean</b>                           | <b>1.0x</b>        | <b>12.7x</b> | <b>9.2x</b>  | <b>12.1x</b>       | <b>37.8x</b> | <b>21.5x</b> | <b>25.0%</b>  | <b>10.7%</b>   | <b>3.6%</b> |
| <b>Median</b>                         | <b>0.9x</b>        | <b>12.4x</b> | <b>9.2x</b>  | <b>12.6x</b>       | <b>30.4x</b> | <b>20.7x</b> | <b>25.4%</b>  | <b>12.5%</b>   | <b>4.0%</b> |
| <b>Wholesalers &amp; Distributors</b> |                    |              |              |                    |              |              |               |                |             |
| Genuine Parts Company                 | 0.9x               | 11.3x        | 10.3x        | 12.0x              | 19.0x        | 18.1         | 31.3%         | 8.4%           | 4.6%        |
| LKQ Corporation                       | 1.9x               | 18.6x        | 16.2x        | 26.0x              | 32.5x        | 27.8         | 45.2%         | 11.6%          | 5.8%        |
| Keystone Automotive Industries, Inc.  | 1.0x               | 15.6x        | 12.6x        | 17.2x              | 25.7x        | 25.6         | 44.7%         | 7.8%           | 3.8%        |
| The Coast Distribution System, Inc.   | 0.4x               | 17.8x        | 14.8x        | 17.0x              | 58.2x        | 23.8         | 18.2%         | 2.8%           | 0.7%        |
| <b>Mean</b>                           | <b>1.0x</b>        | <b>15.8x</b> | <b>13.5x</b> | <b>18.1x</b>       | <b>33.8x</b> | <b>23.8x</b> | <b>34.8%</b>  | <b>7.6%</b>    | <b>3.7%</b> |
| <b>Median</b>                         | <b>0.9x</b>        | <b>16.7x</b> | <b>13.7x</b> | <b>17.1x</b>       | <b>29.1x</b> | <b>24.7x</b> | <b>38.0%</b>  | <b>8.1%</b>    | <b>4.2%</b> |
| <b>Retailers</b>                      |                    |              |              |                    |              |              |               |                |             |
| Autozone, Inc.                        | 1.8x               | 10.6x        | 9.3x         | 11.8x              | 18.8x        | 15.5         | 49.4%         | 19.6%          | 9.7%        |
| Advance Auto Parts, Inc.              | 1.0x               | 11.9x        | 8.8x         | 16.3x              | 21.0x        | 18.9         | 47.9%         | 11.9%          | 5.0%        |
| O'Reilly Automotive, Inc.             | 1.9x               | 15.1x        | 12.4x        | 39.1x              | 24.0x        | 23.3         | 44.2%         | 15.2%          | 7.9%        |
| The Pep Boys - Manny, Moe & Jack      | 0.8x               | 87.1x        | 16.5x        | 30.6x              | NM           | NM           | 25.2%         | 4.8%           | NM          |
| CSK Auto Corporation                  | 0.7x               | 13.9x        | 9.8x         | 13.2x              | 38.0x        | 25.5         | 45.4%         | 7.6%           | 2.0%        |
| US Auto Parts Network, Inc.           | 1.3x               | 53.1x        | 18.8x        | 25.9x              | NM           | NM           | 32.5%         | 7.0%           | 0.7%        |
| <b>Mean</b>                           | <b>1.3x</b>        | <b>27.7x</b> | <b>12.6x</b> | <b>22.2x</b>       | <b>25.4x</b> | <b>20.8x</b> | <b>40.8%</b>  | <b>11.0%</b>   | <b>5.0%</b> |
| <b>Median</b>                         | <b>1.0x</b>        | <b>13.9x</b> | <b>11.1x</b> | <b>16.3x</b>       | <b>22.5x</b> | <b>21.1x</b> | <b>45.4%</b>  | <b>11.9%</b>   | <b>6.4%</b> |

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

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful