

# the aftermarket analyst

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

## Bankruptcy: Nobody's Panacea

Over the last several months, we have seen a rapid increase in distressed situations. For many owners, the distress is attributable to the current economic environment and/or banks that are no longer interested in lending to the auto industry. In the face of declining sales and a challenging lending environment, many owners are questioning the viability of their businesses and exploring the idea of filing for bankruptcy protection. Unfortunately, serious misconceptions abound.

There are two major forms of corporate bankruptcy: Chapter 7 and Chapter 11. Under Chapter 7 of the bankruptcy code, a company ceases all operations and a trustee is appointed to liquidate the company's assets to pay off debt. Very few owners voluntarily file for a Chapter 7 bankruptcy, but may find themselves in this process as a result of an involuntary (forced) bankruptcy or a failed reorganization attempt.

Instead, most business owners try to file under Chapter 11 because it allows them to still run their businesses during the bankruptcy process. Rather than simply turning over its assets to a trustee, a company undergoing Chapter 11 has the opportunity to restructure its financial framework and be profitable again. If it fails, all assets are liquidated and stakeholders are paid off according to absolute priority.

Bankruptcy, particularly a Chapter 11 reorganization, has taken on a mythical allure of a quick fix for businesses. Seemingly all business owners are aware of a company

that files Chapter 11 and becomes a prosperous entity. In reality, the rate of successful Chapter 11 reorganizations is depressingly low, sometimes estimated at 10% or less. Usually, the fundamental business model cannot be changed significantly and the company is ultimately liquidated. We continue to see businesses whose owners have not fully addressed selling the company or raising capital before being forced into bankruptcy. Whether it's due to pride, eternal optimism or misinformation, many business owners elect to file for Chapter 11 bankruptcy protection rather than earnestly seek capital for the business.

Also, some companies are just simply too broke to file for Chapter 11. If the company cannot demonstrate that it will have sustainable cash flow and/or the ability to obtain financing, it's hard for the court to let it remain in Chapter 11, and it goes straight to a Chapter 7 liquidation. Moreover, debtor-in-possession (DIP) financing should almost always be obtained before filing, and, in this lending environment, DIP financing is usually only available from the incumbent lender. The company has to show that the current secured senior lender will not suffer loss upon the funding of the DIP financing.

Another issue that faces owners considering a Chapter 11 filing is the size and security interest of debtors. Companies with a larger proportion of unsecured creditors versus secured creditors are in a better position to benefit from a Chapter 11 filing than those with a large

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**RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS**

Announce Date	Acquirer/Investor(s)	Target	Target Description	Firm Value (\$mil.)	FV / Rev.	FV / EBITDA
3/3/2009	General Motors	Delphi	Delphi's steering division	—	—	—
2/23/2009	FleetPride	Multibearings Service Co.	supplier of heavy duty truck and trailer parts and offers in-house remanufactured products	—	—	—
2/23/2009	Safety-Kleen	Atlantic Industrial Services Inc.	one of the largest collectors and recyclers of used oil, oil filters and antifreeze in the Southeast	—	—	—
2/23/2009	Safety-Kleen	Gateway Petroleum Co.	provides used oil management services to customers in the eastern Missouri, central and southern Illinois, and Cape Girardeau areas.	—	—	—
1/16/2009	The Mifsud Group	JB Design Inc.	a.k.a. Corsa Performance Exhausts	—	—	—
1/15/2009	Aurelius	Bosch	Bosch's Blaupunkt brand, which makes portable navigation devices	—	—	—
1/9/2009	Comp Cams	Hawk Corp.	the clutch assemblies specialist (Quarter Master Industries) was the last remaining piece of Hawk's performance racing operations	—	—	—
1/7/2009	Belron US	Cindy Rowe Auto Glass	a prominent vehicle glass repair and replacement brand in the central Pennsylvania area	—	—	—
1/6/2009	FleetPride	E.H. Burrell	a wholesale distributor of parts and accessories for commercial trucks and heavy equipment that serves 1,000 commercial and industrial accounts throughout western Oregon and southwestern Washington State	—	—	—
1/6/2009	Aero Performance Products	Jones Exhaust Products	one of the largest manufacturers of chrome exhaust tips and glasspack mufflers and performance diesel systems in the U.S.	—	—	—
1/5/2009	Speedway Motors	Kentucky Speedway	motorsports facility just south of Cincinnati, Kentucky	—	—	—
12/30/2008	Paul Lee (Individual)	McLeod Industries Inc.	a U.S.-based manufacturer of high-performance automotive clutch assemblies for performance automotive enthusiasts and the auto industry	—	—	—
12/29/2008	Champion Parts	Turbomotive Inc.	acquired certain turbocharger technology assets of Turbomotive Inc. for \$1.75 million	—	—	—
12/22/2008	American Tire Distributors	Am-Pac Tire	a wholly owned subsidiary of Tokyo-based Itochu Corp., which purchased the assets of Aspen Enterprises Inc. and its Tire Pros assets in 1999	—	—	—
12/5/2008	Speedway Motors	A-FAB Corp.	manufacturers AFCO-branded premium shocks, springs and radiators; U.S. Brake-branded automotive brakes; and Dynatech premium exhaust systems	—	—	—
12/5/2008	American Axle & Manufacturing	FormTech Industries	AAM exchanged its hub and spindle forging business for FormTech's differential gear, hypoid pinion and ring gear forging businesses	—	—	—
12/4/2008	Audax Group	Select Distributors, Inc.	a manufacturer and distributor of custom car audio installation accessories and materials	—	—	—

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secured creditor that doesn't deem itself "under water." A company with \$5 million in unsecured payables and a \$15 million line of credit secured by all assets of the company will face greater obstacles than a company with \$15 million in unsecured payables and a \$5 million secured loan.

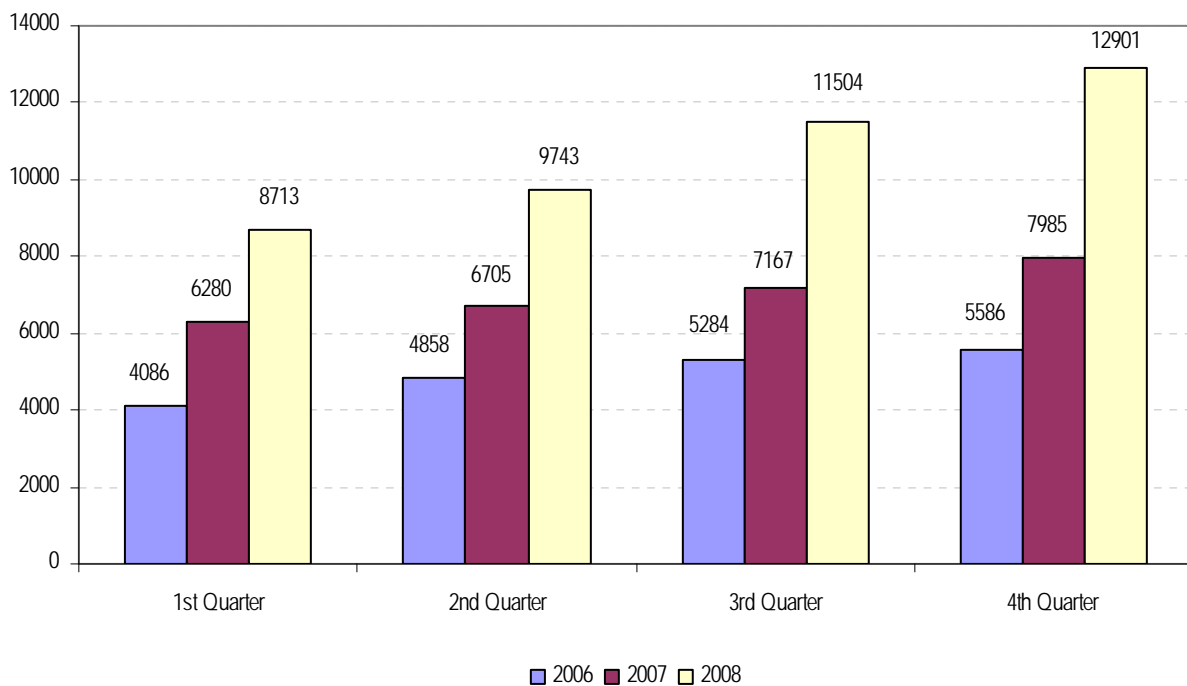
In today's environment, a Chapter 11 filing merely prolongs the inevitable for many companies. Typically, revenues have fallen off for the company without a corresponding decrease in expenses. In many cases, a company can not attain the necessary decrease in expenses given the level of fixed costs. However, a buyer can be brought in that can reduce the operating expenses via consolidation of facilities, personnel, and distribution relationships. Additionally, many buyers will have the banking relationships and means to properly

capitalize the company moving forward.

We have seen many businesses that are liquidated because they were not willing to explore the possibility of selling or raising capital. We are seeing liquidation values at significant discounts to asset values or orderly liquidation values. These decreased values are particularly important for owners who have provided the bank with a personal guarantee.

There are interested buyers in the marketplace that are looking for distressed opportunities, and they are willing to invest before or after a bankruptcy filing (but of course, the seller's equity may be wiped out if the investment takes place after a filing). These investors are also willing to participate in "common law" transactions such as Assignments for the Benefit of Creditors.

### Quarterly Business Bankruptcy Filings



#### 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**  
 (\$ in millions, except per share data)

Company	Enterprise Value					Last Twelve Months (LTM)			
	Price as of 1/31/09	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	Net Income
<b>Manufacturers</b>									
Federal-Mogul Corporation	\$5.76	\$572.5	\$2,907.7	\$781.5	\$2,750.0	9/30/08	\$7,294.9	\$760.2	\$456.6
Aftermarket Technology Corp.	13.05	264.7	0.0	5.5	259.7	9/30/08	539.9	71.8	35.4
Tenneco Automotive, Inc.	1.84	86.0	1,524.0	127.0	1,518.0	9/30/08	6,273.0	405.0	(193.3)
Dorman Products, Inc.	9.99	176.3	21.0	7.1	193.6	9/30/08	346.1	37.5	16.9
Standard Motor Products, Inc.	2.35	43.9	250.4	11.0	283.3	9/30/08	793.6	34.2	13.1
<b>Wholesalers &amp; Distributors</b>									
Genuine Parts Company	\$32.02	\$5,105.1	\$500.0	\$124.4	\$5,549.1	9/30/08	\$11,122.3	\$932.9	\$513.7
LKQ Corporation	11.55	1,566.1	642.5	97.7	2,171.7	9/30/08	1,881.7	251.2	112.8
The Coast Distribution System, Inc.	1.10	4.9	20.7	3.3	22.3	9/30/08	142.0	0.7	(1.1)
<b>Retailers</b>									
Autozone, Inc.	\$132.89	\$7,636.5	\$2,268.2	\$85.8	\$9,953.7	11/22/08	\$6,545.3	\$1,295.3	\$640.5
Advance Auto Parts, Inc.	32.73	3,099.2	471.2	21.3	3,549.4	10/4/08	4,998.2	578.8	248.4
O'Reilly Automotive, Inc.	29.07	3,894.6	665.4	26.4	4,569.8	9/30/08	3,066.2	397.6	191.0
The Pep Boys - Manny, Moe & Jack	2.89	150.6	332.6	38.4	444.9	11/1/08	1,979.9	59.8	(28.5)
US Auto Parts Network, Inc.	1.36	40.6	0.1	33.1	7.5	9/30/08	157.0	7.6	(2.1)

**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>									
Federal-Mogul Corporation	0.4x	7.7x	3.6x	6.4x	6.0x	1.3	16.7%	10.4%	6.3%
Aftermarket Technology Corp.	0.5x	4.6x	3.6x	4.6x	7.3x	7.5	22.7%	13.3%	6.6%
Tenneco Automotive, Inc.	0.2x	8.3x	3.7x	10.0x	NM	NM	14.7%	6.5%	NM
Dorman Products, Inc.	0.6x	6.5x	5.2x	6.4x	11.5x	10.4	32.5%	10.8%	4.9%
Standard Motor Products, Inc.	0.4x	14.5x	8.3x	13.0x	21.7x	3.4	23.7%	4.3%	1.6%
<b>Mean</b>	<b>0.4x</b>	<b>8.3x</b>	<b>4.9x</b>	<b>8.1x</b>	<b>11.6x</b>	<b>5.6x</b>	<b>22.0%</b>	<b>9.1%</b>	<b>4.8%</b>
<b>Median</b>	<b>0.4x</b>	<b>7.7x</b>	<b>3.7x</b>	<b>6.4x</b>	<b>9.4x</b>	<b>5.4x</b>	<b>22.7%</b>	<b>10.4%</b>	<b>5.6%</b>
<b>Wholesalers &amp; Distributors</b>									
Genuine Parts Company	0.5x	6.6x	5.9x	6.6x	10.8x	9.9	29.7%	8.4%	4.6%
LKQ Corporation	1.2x	9.9x	8.6x	11.0x	19.3x	13.9	44.9%	13.4%	6.0%
The Coast Distribution System, Inc.	0.2x	NM	30.4x	NM	NM	NM	19.2%	0.5%	NM
<b>Mean</b>	<b>0.6x</b>	<b>8.2x</b>	<b>15.0x</b>	<b>8.8x</b>	<b>15.0x</b>	<b>11.9x</b>	<b>31.2%</b>	<b>7.4%</b>	<b>5.3%</b>
<b>Median</b>	<b>0.5x</b>	<b>8.2x</b>	<b>8.6x</b>	<b>8.8x</b>	<b>15.0x</b>	<b>11.9x</b>	<b>29.7%</b>	<b>8.4%</b>	<b>5.3%</b>
<b>Retailers</b>									
Autozone, Inc.	1.5x	8.8x	7.7x	9.5x	15.5x	11.9	50.2%	19.8%	9.8%
Advance Auto Parts, Inc.	0.7x	8.2x	6.1x	9.4x	14.3x	12.5	48.3%	11.6%	5.0%
O'Reilly Automotive, Inc.	1.5x	14.3x	11.5x	61.4x	23.9x	20.4	45.1%	13.0%	6.2%
The Pep Boys - Manny, Moe & Jack	0.2x	NM	7.4x	16.4x	NM	NM	23.9%	3.0%	NM
US Auto Parts Network, Inc.	0.0x	NM	1.0x	2.4x	NM	NM	33.8%	4.8%	NM
<b>Mean</b>	<b>1.0x</b>	<b>10.5x</b>	<b>6.7x</b>	<b>24.2x</b>	<b>17.9x</b>	<b>14.9x</b>	<b>40.2%</b>	<b>10.4%</b>	<b>7.0%</b>
<b>Median</b>	<b>1.1x</b>	<b>8.8x</b>	<b>7.4x</b>	<b>13.0x</b>	<b>15.5x</b>	<b>12.5x</b>	<b>46.7%</b>	<b>12.3%</b>	<b>6.2%</b>

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

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful