

the aftermarket analyst

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

What do we do now?

The last 18 months have decimated many companies throughout the world, including hundreds in the automotive aftermarket. Companies are desperately trying to find their way through a new business landscape riddled with uncertainty. Lack of available credit, declining consumer confidence, and decreased sales are the norm in the current global economic downturn.

These issues were frequently discussed at Auto Aftermarket Industry Week in Las Vegas last month. For this important issue of The Aftermarket Analyst, we have dissected results of our findings from Industry Week into six segments: hard parts, accessories, light truck products, performance products, chemicals and distributors. We will then discuss possible alternatives for companies in the industry.

Companies in the hard parts segment are down from 0-10% for the year, which was expected since Miles Driven, the largest determinant of hard parts demand, is off 5% year over year. Most of the hard parts are non-discretionary in nature and don't have the sales volatility or unpredictability that is evident in the DIY and accessories market. Hard parts manufacturers repeatedly talked of strained relationships with larger warehouse distributors to the point of selling products outside of the WD channel. Many hard parts manufacturers are very interested in the M&A market. Some are looking to "take some money off of the table" in the form of a buyout or recapitalization, while others are interested in growing their business via acquisitions. Ultimately, these companies are realizing that maintaining the status quo is no longer a viable option and that the current economy dictates action.

The car accessory category includes styling accessories and "soft" products, and these manufacturers tend to be down roughly 10%, but with heightened sales volatility. We know of companies that are up 20% for the year and those that are

down 40% for the year. The accessory category is driven by innovation and distribution, with innovative companies utilizing diverse distribution channels achieving success. Those companies that are producing the same tired commodity products with classic three-step distribution model are faltering. This model will become more difficult to sustain in the future as the nation's largest warehouse distributors have announced plans to decrease SKUs.

Manufacturers of truck accessories are down 25%, with some of these companies down as much as 60%. One word to describe most of the truck market is "despair." Declining truck sales have eroded the truck accessories market to the point that we believe up to 30% of current manufacturers will not be around in 12 months. Again, this segment is driven by innovation, distribution and strong management teams. This segment has been the worst victim of the "accordion effect" prevalent in the industry's classic three-step distribution. When gas prices shot up and truck sales tanked, consumers stopped buying trucks and associated "new truck" accessories. When consumers stopped buying a little, dealers stopped buying more, and the WDs stopped buying even more, enhancing this accordion effect geometrically.

Surprisingly, performance product manufacturers seem to be fairly stable during this economic downturn, with most manufacturers down from 0 – 20%, but several actually having sales increases. We attribute this trend to the stability of many segments of the racing industry. Not surprisingly, the chemicals segment is the industry's most resilient. When consumers can no longer afford to purchase new vehicles or even the fuel for them, they want to preserve the ones they have by purchasing the industry's cleaning, polishing and additive products. Generally, the producers of these products have shown sales increases this year of 10 -15%.

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RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS

Announce Date	Acquirer/Investor(s)	Target	Target Description	Firm Value (\$mil.)	FV / Rev.	FV / EBITDA
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	—	—	—
12/3/2008	Perfection (Berkshire Hathaway)	Affinia	the clutch hydraulic business from Affinia's Global Brake and Chassis business unit	—	—	—
12/2/2008	Cerion LLC	Hillsdale Automotive	a provider of precision-machined and assembled powertrain and chassis components to the automotive industry	—	\$ 100.0	—
11/21/2008	General Dynamics	AxleTech International	a global manufacturer and supplier of axles, axle components, planetary axles, independent suspensions, brakes and aftermarket parts for military vehicles, commercial specialty trucks and off-highway machines	—	—	—
11/21/2008	OMIX-ADA	Alloy USA/Precision Gear	Alloy USA makes aftermarket performance axle and drive components for autos, trucks and SUVs. Precision Gear is a full-line axle component distributor	—	—	—
11/21/2008	Management buyout	Weld Wheel Industries Inc.	manufacturer of aftermarket and racing wheels	—	—	—
11/18/2008	FleetPride	Automotive Brake Co. of Newburgh, Inc.	auto parts distributor with 2 locations in New York State	—	—	—
11/16/2008	Keystone	Arrow Speed Warehouse	auto parts distributor	—	—	—
11/13/2008	Affinia Group	HBM Investment Ltd.	one of the world's largest drum and rotor manufacturing companies	—	—	—
11/11/2008	FleetPride	E.H. Burrell Co.	a distributor of OEM and aftermarket parts serving western Oregon and southwest Washington	—	—	—
11/1/2008	Marmon Highway Tech.	TSE Brakes	produces brake actuators in Sonora, Mexico	—	—	—
10/31/2008	US Auto Parts	AutoMD.com	a provider of diagnosis and repair technology to help consumers understand what's wrong with their vehicles and guide them in determining how to repair	—	—	—
10/31/2008	Westin	T-Max LLC	the North American distributor for the T-Max Hangzhou Industrial Co., a manufacturer of winches, recovery systems and related off-road accessories	—	—	—
10/31/2008	Don Youngblood	Atlantic Pacific Automotive	distributor which sells to jobbers and distributors both domestically and around the world, based in Germantown, TN.	—	—	—
10/30/2008	Donaldson Co.	Western Filter Corp.	manufactures filters for hydraulic oil, fuel, lube oil and coolant systems used in a wide array of commercial and military aircraft and helicopters, military ground vehicles and naval shipboard systems	—	—	—
10/17/2008	LKQ Corp.	Automotive Rebuilders Supply Co.	a recycled heavy-duty truck parts business located in the Chicago area	—	9.5	—

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Distributors are the big question mark in this yearend survey. Almost all distributors in every category are down 20 – 40% this year, with the actual drop in this range dependent on the respective distributor's segment specialization and geographical reach. Most of these are partaking of either the merger or roll-up solution outlined below. One of these well-known distributors admitted to us that he waited 8 months too late to do so.

So what do we do?

There are some things in life that money will fix. Many of the industry's problems don't qualify as these "things." However, there are several answers that use OPM (Other People's Money) as the genesis of a long-term solution.

Like the \$76 per hour laborers working for the Detroit OEs, many of these problems are self-inflicted. Manufacturers shouldn't expect that their goods can pass through three or even four hands (read: "steps") and be sold to the end user for a price that a consumer is willing to pay when he or she can Google the lowest price paid for all such products. In our March 2007 issue of *Aftermarket Analyst*, we forecasted this trend. 74% of the readers agreed, but too few acted in time, and this trend is now affecting every manufacturer and every step in the distribution chain. *[Editor's note: readers may not know that Capstone owns three Ford dealerships, so we know of what we speak!]*

In addition to creating too many levels of profit-taking, this distribution method has stifled innovation, since many WDs will buy products from all manufacturers, thus creating an inherent commoditization of these products. Please note that we are not talking here about specialty WDs that actually add value and have a proprietary customer base, allowing them to sometimes skip a channel of distribution.

So what are the solutions we are enacting these days to help solve the above problems? The answers include:

1. Mergers. Since the beginning of time, the "M" in "M&A" has stood for "Mergers," but there really haven't been

many true mergers in the aftermarket. Until now. The reason is that true mergers don't usually involve cash, but just the exchange of shares of stock in two companies. However, these may sometimes involve a buyer which purchases both companies and provides the liquidity necessary for these companies to buy themselves out of their distribution and product development problems. This tactic is important with manufacturers who can combine facilities and dramatically decrease overhead. A significant example of this solution is our deal of a few months ago in which we simultaneously closed the merger of two of the leading soft tonneau cover manufacturers, Extang and TruXedo. Indeed, these manufacturers, which were both purchased by a Private Equity Group, have continued to gain market share and witnessed the closing of several smaller competitors. This product category, as with many in the aftermarket, may be a "last man standing" or at least, a "last 2 or 3 men standing" scenario. A merger salvages the value of many manufacturers and insures they'll be around when the counting is done. These deals are also particularly prevalent today with distributors since they can combine inventories, SG&A expenses and logistics to achieve more geographical reach.

2. Roll-ups. These are mergers, but usually involve three or more companies which close simultaneously. The deal is inherently more complicated, but the compliance of three similar companies may be necessary for many companies to combat the power of their 800-pound gorilla customers and competitors. This strategy may also be necessary for distributors forced to combine in order to survive.
3. Recapitalizations. These transactions usually involve the purchase of 55-60% of a company's shares and are consummated by Private Equity Groups, which then provide the needed capitalization. The purchase percentage has dropped in recent months because of the dearth of cash flow financing, but these PEGs are still actively seeking deals in the aftermarket.

There are solutions to the industry's quagmire. Please call us for clarifications on the above.

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.

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

Company	Enterprise Value					Last Twelve Months (LTM)			
	Price as of 11/30/08	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	Net Income
Manufacturers									
Federal-Mogul Corporation	\$5.29	\$525.8	\$2,907.7	\$781.5	\$2,703.3	9/30/08	\$7,294.9	\$760.2	\$456.6
Aftermarket Technology Corp.	17.29	350.7	0.0	5.5	347.3	9/30/08	539.9	71.8	35.4
Tenneco Automotive, Inc.	3.28	153.4	1,524.0	127.0	1,585.4	9/30/08	6,273.0	405.0	(193.3)
Dorman Products, Inc.	11.95	210.9	21.0	7.1	229.8	9/30/08	346.1	37.5	16.9
Standard Motor Products, Inc.	2.49	46.5	250.4	11.0	285.9	9/30/08	793.6	34.2	13.1
Wholesalers & Distributors									
Genuine Parts Company	\$38.73	\$6,175.0	\$500.0	\$124.4	\$6,623.6	9/30/08	\$11,122.3	\$932.9	\$513.7
LKQ Corporation	10.42	1,412.9	642.5	97.7	2,007.7	9/30/08	1,881.7	251.2	112.8
The Coast Distribution System, Inc.	0.85	3.8	20.7	3.3	21.2	9/30/08	142.0	0.7	(1.1)
Retailers									
Autozone, Inc.	\$109.22	\$6,331.9	\$2,250.0	\$242.5	\$8,405.9	8/30/08	\$6,522.7	\$1,293.6	\$641.6
Advance Auto Parts, Inc.	30.36	2,874.8	471.2	21.3	3,324.7	10/4/08	4,998.2	578.8	248.4
O'Reilly Automotive, Inc.	26.07	3,492.6	665.4	26.4	4,148.2	9/30/08	3,066.2	397.6	191.0
The Pep Boys - Manny, Moe & Jack	4.50	233.3	337.9	56.2	514.9	8/2/08	2,044.5	31.0	(47.1)
US Auto Parts Network, Inc.	2.08	62.1	0.1	33.1	29.0	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
Manufacturers									
Federal-Mogul Corporation	0.4x	7.5x	3.6x	6.3x	5.9x	1.2	16.7%	10.4%	6.3%
Aftermarket Technology Corp.	0.6x	6.2x	4.8x	6.1x	9.8x	9.9	22.7%	13.3%	6.6%
Tenneco Automotive, Inc.	0.3x	8.7x	3.9x	10.4x	NM	NM	14.7%	6.5%	NM
Dorman Products, Inc.	0.7x	7.7x	6.1x	7.6x	13.6x	12.5	32.5%	10.8%	4.9%
Standard Motor Products, Inc.	0.4x	14.6x	8.4x	13.1x	21.9x	3.6	23.7%	4.3%	1.6%
Mean	0.5x	8.9x	5.4x	8.7x	12.8x	6.8x	22.0%	9.1%	4.8%
Median	0.4x	7.7x	4.8x	7.6x	11.7x	6.7x	22.7%	10.4%	5.6%
Wholesalers & Distributors									
Genuine Parts Company	0.6x	7.9x	7.1x	7.9x	12.9x	12.0	29.7%	8.4%	4.6%
LKQ Corporation	1.1x	9.1x	8.0x	10.2x	17.8x	12.5	44.9%	13.4%	6.0%
The Coast Distribution System, Inc.	0.1x	NM	28.9x	NM	NM	NM	19.2%	0.5%	NM
Mean	0.6x	8.5x	14.7x	9.0x	15.3x	12.3x	31.2%	7.4%	5.3%
Median	0.6x	8.5x	8.0x	9.0x	15.3x	12.3x	29.7%	8.4%	5.3%
Retailers									
Autozone, Inc.	1.3x	7.5x	6.5x	8.0x	13.1x	9.9	50.1%	19.8%	9.8%
Advance Auto Parts, Inc.	0.7x	7.7x	5.7x	8.8x	13.4x	11.6	48.3%	11.6%	5.0%
O'Reilly Automotive, Inc.	1.4x	13.0x	10.4x	55.8x	21.7x	18.3	45.1%	13.0%	6.2%
The Pep Boys - Manny, Moe & Jack	0.3x	NM	16.6x	NM	NM	NM	22.3%	1.5%	NM
US Auto Parts Network, Inc.	0.2x	NM	3.8x	9.1x	NM	NM	33.8%	4.8%	NM
Mean	0.9x	9.4x	8.6x	24.2x	16.1x	13.2x	39.9%	10.1%	7.0%
Median	1.0x	7.7x	6.5x	8.8x	13.4x	11.6x	46.7%	12.3%	6.2%

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

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful