

the aftermarket analyst

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

Five Stages of a Turnaround

Rising competition, cyclical financial markets and economic volatility have created a climate where no business can take economic stability for granted. As once-stable companies struggle to maintain profitability, it is important to understand what it takes to complete a successful corporate turnaround.

The following tips from the Turnaround Management Association* outline critical stages of a successful turnaround by addressing issues such as timing, common obstacles, making the critical decisions, who to turn to for help, and how to maintain profitability.

1.) Stage One: Replacing Top Management

Most CEOs or company presidents don't relinquish power easily. Often their egos make it hard for them to admit such a downturn is really happening or that they are unable to pull the company out of its nosedive. After hiring a turnaround specialist, steps should be taken to replace top managers or weak board members who might impede the turnaround process, and to put into place a top management team who will most successfully lead the turnaround effort.

2.) Stage Two: Analyzing the Situation

Before a turnaround specialist makes any major changes, he or she must determine the chances of the business's survival, identify appropriate strategies and develop a preliminary action plan.

The early stage of a turnaround process should involve fact-finding and diagnosing the scope and severity of the company's problems. Is it in imminent danger of failure? Does it have substantial losses but its survival is not yet

threatened or is it merely in a declining business position?

The first three requirements for viability are analyzed: one or more viable core businesses, adequate bridge financing, and adequate organizational resources. A more detailed assessment of strengths and weaknesses follows in the areas of competitive position, engineering and R&D, finances, marketing, operations, organizational structure, and personnel.

Once major problems and opportunities are identified, the turnaround professional develops a strategic plan with specific goals and detailed functional actions. This plan must then be sold to all key parties in the company, including the board of directors, management team and employees. Also presenting the plan to key parties outside the company—bankers, major creditors and vendors—should regain their confidence.

3.) Stage Three: Implementing an Emergency Action Plan

If the company is in a critical stage, an appropriate action plan must be developed to stop the bleeding and enable the organization to survive. The plan typically includes financial, marketing and operations actions to restructure debts, improve working capital, reduce costs, improve budgeting practices, correct pricing, prune product lines and accelerate high potential products.

Cash is the lifeblood of the business. A positive operating cash flow must be established as quickly as possible and enough cash to implement the turnaround strategies must be raised. Often, unprofitable divisions or business units are unloaded. Frequently, the turnaround specialist will apply some quick, corrective surgery before placing them on the

*Reprinted from the Turnaround Management Association, <http://www.turnaround.org/>

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RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS

Announce Date	Acquirer/Investor(s)	Target	Target Description
10/28/2009	The Carlyle Group	Broadleaf	provides automotive after-market software to the Japanese car repair & inspection industry
10/23/2009	Madison Capital Partners	SPX Corp.	completed the sale of its Filtran business unit, a global leader in automotive filtration solutions
10/23/2009	FleetPride	Angelo Fleet and Industrial Supply	the primary independent heavy-duty parts distributor in San Angelo and its surrounding markets
10/16/2009	W.W. Grainger	Imperial Supplies LLC	a national distributor of maintenance products and aftermarket components for the vehicle and fleet industry, specializing in supplying fasteners, hardware, shop supplies, vehicle lighting products, air brake products and more
10/9/2009	LKQ	Greenleaf Auto Recyclers	automobile recycling operation
10/5/2009	Hephaestus Holdings, Inc.	FormTech Industries, LLC	independent manufacturer of forged parts and a leading manufacturer of wheel bearings for the North American automotive industry
10/2/2009	JohnDow Industries	Dynamic Merchandising Inc.	a national supplier of automotive fasteners, hardware, and parts
9/24/2009	Monroe Motor Products	Ronald Hinson Enterprises	a regional parts distributor
9/24/2009	Monro Muffler Brake	Tire Warehouse Central	a privately-owned tire store chain serving five New England states
9/24/2009	Monro Muffler Brake	Midwest Tire & Auto Repair	a small independent tire chain in northwest Indiana
9/22/2009	Ioche-Maxion S.A.	Arvin Meritor	Arvin Meritor's wheels business -- formerly a division of the company's Light Vehicle Systems segment
9/8/2009	Azalea Capital	Milliken & Co.	its global automotive body cloth division and has renamed the company SAGE Automotive Interiors Inc.
9/8/2009	Henkel	National Adhesive	lighting adhesives and sealant technologies for automotive lamp assemblies
9/1/2009	Continental	Matador Rubber	Slovak Republic-based truck tire plant
8/29/2009	Manufacturas Diversas	ROL Manufacturing	Manufacturas Diversas will acquire the assets of ROL's Engine Gasket division in the U.S., Canada, and Mexico
8/20/2009	Motorcar Parts of America	Reliance Automotive Inc.	a privately held remanufacturer of alternators and starters based in East Berlin, Conn
8/18/2009	Genuine Parts Co.	Uni-Select	assets of its Heavy Duty Group, also known as Palmar, that provides replacement parts, tools and accessories for heavy-duty vehicles
8/17/2009	Wynnchurch Capital	Centrum Equities, XV (Visteon)	a holding company that had previously acquired select aftermarket assets of Visteon Corporation in 2008, and substantially all of the North American assets and operations of Proliance International Inc.
8/10/2009	The Carlyle Group/Solus	Metaldyne	bankrupt auto parts supplier
7/31/2009	Katcon	Delphi	Delphi's catalytic converter and exhaust system global business
7/23/2009	FleetPride	Panhandle Truck Parts	an independent aftermarket distributor of heavy-duty truck and trailer parts serving Amarillo and Lubbock, TX.

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market. If the unit fails to attract a buyer in a given time frame, liquidation occurs.

At this time emotions run high; employees are laid off or entire departments eliminated. After sizing up the situation objectively, the skilled turnaround leader must implement these decisions quickly and fairly.

The status quo is challenged and those who change as a result of the plans are rewarded and those who don't are sanctioned. In a typical turnaround, the new company emerges from the operating table, a smaller organization but no longer losing cash.

4.) Stage Four: Restructuring the Business

Once the bleeding has stopped, the losing divisions sold off and the administrative costs cut, turnaround efforts should be directed toward making remaining operations as effective and efficient as possible. This may require further restructuring to increase profits and return on assets and equity.

The financial state of the company's core business is particularly important. If the core business is irreparably damaged, then the outlook for the entire company may be bleak. If the remaining corporation is capable of long-term survival, it must now concentrate on sustained profitability and the smooth operation of existing facilities.

During the turnaround, the product mix may have changed, requiring the company to do some repositioning. Core products neglected over time require immediate attention to remain competitive. In the new, leaner company, some facilities might be closed; the company may even withdraw from certain markets or target its products toward a different niche.

The "people mix" is another important ingredient in the company's competitive effectiveness. Reward and compensation systems that encourage dedication and

creativity encourage employees to think "profits" and "return on investment."

5.) Stage Five: Returning To Normal

In the final stage of the turnaround process, the company should begin to show signs of profitability. While earlier steps concentrated on correcting problems, stage five focuses on profitability, return-on-equity and enhancing economic value-added.

Financially, the emphasis shifts from cash flow concerns to maintaining a strong balance sheet, long-term financing, and strategic accounting and control systems.

From a marketing point of view, emphasis is placed on a number of strategic efforts including: initiating new marketing programs to broaden its business base and increase market penetration; carefully adding new products and improving customer service; creating alliances with other world-class organizations.

This final step cannot be successful without a psychological shift as well. Rebuilding momentum and morale is almost as important as rebuilding the ROI. It means a rebirth of the corporate culture and transforming the negative attitudes to positive, confident ones as the company maps out its future.

Success or Failure

Of course, not all turnarounds succeed in the manner outlined here. A company may put a quick end to its disastrous losses but never quite attain an acceptable return position. When this occurs, management may decide to sell the business to a company better able to produce an acceptable return on the funds invested. On the other hand, the turnaround may be so successful that the company becomes a target of a takeover bid. In either scenario, the turnaround manager plays a key role in identifying prospective purchasers or analyzing the takeover prospect, and then negotiating a successful sale.

About Capstone

Capstone Financial Group, Inc. 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 10/31/09	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	Net Income
Manufacturers									
Federal-Mogul Corporation	\$11.15	\$1,108.4	\$2,862.2	\$784.3	\$3,249.0	9/30/09	\$5,241.2	\$330.3	(\$243.6)
ATC Technology Corporation	20.90	417.8	70.0	129.7	358.1	9/30/09	486.2	75.0	26.2
Tenneco Automotive, Inc.	13.62	645.5	1,468.0	137.0	2,002.5	9/30/09	4,535.0	242.0	(312.4)
Dorman Products, Inc.	14.62	257.8	6.3	5.7	265.6	9/30/09	361.4	45.0	23.6
Standard Motor Products, Inc.	10.04	191.5	110.9	10.5	291.9	9/30/09	724.2	39.2	11.1
Wholesalers & Distributors									
Genuine Parts Company	\$34.61	\$5,522.1	\$500.0	\$363.1	\$5,666.4	9/30/09	\$10,106.5	\$753.3	\$388.2
LKQ Corporation	17.27	2,421.3	636.6	129.5	3,043.6	9/30/09	1,985.6	247.3	110.0
The Coast Distribution System, Inc.	2.98	13.3	11.5	2.6	22.2	9/30/09	102.8	(0.3)	(1.1)
Retailers									
Autozone, Inc.	\$135.31	\$6,747.7	\$0.0	\$0.0	\$6,861.0	8/29/09	\$6,816.8	\$1,356.5	\$657.0
Advance Auto Parts, Inc.	37.21	3,521.2	279.5	216.2	3,594.3	10/10/09	5,461.4	592.1	260.3
O'Reilly Automotive, Inc.	37.28	5,114.5	703.7	29.5	5,859.4	9/30/09	4,788.0	600.2	278.3
The Pep Boys - Manny, Moe & Jack	8.77	458.9	309.4	21.9	746.4	8/1/09	1,915.1	76.1	(20.8)
US Auto Parts Network, Inc.	5.35	159.7	0.0	33.6	126.1	9/30/09	164.3	5.8	(2.7)

Selected Public Company Multiples and Operating Statistics

Company	Enterprise Value /						Margins		
	Revenue	EBIT	EBITDA	Free Cash Flow (2)	Net Income	P / E Ratio	Gross Margins	EBITDA Margins	Net Margins
Manufacturers									
Federal-Mogul Corporation	0.6x	NM	9.8x	30.9x	NM	NM	14.3%	6.3%	NM
ATC Technology Corporation	0.7x	5.9x	4.8x	5.3x	13.7x	16.0	23.1%	15.4%	5.4%
Tenneco Automotive, Inc.	0.4x	77.0x	8.3x	17.4x	NM	NM	15.5%	5.3%	NM
Dorman Products, Inc.	0.7x	7.1x	5.9x	7.1x	11.3x	10.9	33.6%	12.4%	6.5%
Standard Motor Products, Inc.	0.4x	12.0x	7.5x	9.3x	26.3x	17.2	23.8%	5.4%	1.5%
Mean	0.6x	25.5x	7.2x	14.0x	17.1x	14.7x	22.1%	9.0%	4.5%
Median	0.6x	9.6x	7.5x	9.3x	13.7x	16.0x	23.1%	6.3%	5.4%
Wholesalers & Distributors									
Genuine Parts Company	0.6x	8.5x	7.5x	8.6x	14.6x	14.2	29.6%	7.5%	3.8%
LKQ Corporation	1.5x	14.5x	12.3x	15.7x	27.7x	22.0	44.6%	12.5%	5.5%
The Coast Distribution System, Inc.	0.2x	NM	NM	NM	NM	NM	18.2%	NM	NM
Mean	0.8x	11.5x	9.9x	12.2x	21.1x	18.1x	30.8%	10.0%	4.7%
Median	0.6x	11.5x	9.9x	12.2x	21.1x	18.1x	29.6%	10.0%	4.7%
Retailers									
Autozone, Inc.	1.0x	5.8x	5.1x	6.3x	10.4x	10.3	50.1%	19.9%	9.6%
Advance Auto Parts, Inc.	0.7x	8.1x	6.1x	8.7x	13.8x	13.5	49.2%	10.8%	4.8%
O'Reilly Automotive, Inc.	1.2x	11.9x	9.8x	29.1x	21.1x	18.4	47.5%	12.5%	5.8%
The Pep Boys - Manny, Moe & Jack	0.4x	NM	9.8x	19.7x	NM	NM	24.3%	4.0%	NM
US Auto Parts Network, Inc.	0.8x	NM	21.7x	NM	NM	NM	36.3%	3.5%	NM
Mean	0.8x	8.6x	10.5x	16.0x	15.1x	14.1x	41.5%	10.2%	6.7%
Median	0.8x	8.1x	9.8x	14.2x	13.8x	13.5x	48.3%	11.7%	5.8%

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

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful