

# the aftermarket analyst

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

## Beware of Unlicensed M&A Advisors

One of the key elements when buying or selling a business is choosing an advisor, and it is critically important to choose an advisor that is properly licensed. The SEC, formed in the Securities Exchange Act of 1934 (the "Act"), is specific when it states that no U.S. person can be compensated for referring/introducing capital in a public or private offering of securities unless they are properly licensed (i.e., a licensed broker-dealer). Though the rules have changed over the last few years, such an offering of "securities" now includes the sale of "stock" in privately held companies as well as interests in most limited liability companies. In other words, *the corporate stock of any auto aftermarket company is a security, and the sale of that stock must be handled only by M&A advisors that hold the proper securities licenses.*

Under federal law, there are certain litmus tests which determine if an advisor is considered a *securities* "broker" or "dealer" (referred to collectively under most state laws as a "broker-dealer") and must therefore be licensed. Generally, these criteria include any person who:

- brings together potential buyers and sellers and advises the parties on questions of value;
- receives compensation related to the outcome or size of the transaction;
- receives "transaction-based compensation," such as a success fee paid only at closing or a commission tied to the amount of funds the broker brings to the company; or
- has a material participation in *securities* transactions, e.g.:
  - ◊ actively soliciting investors;
  - ◊ being involved in negotiations; or
  - ◊ being involved in structuring the transaction.

## Potential Risks to Sellers

Using an M&A advisor who is not registered as a broker-dealer to assist with the sale of corporate shares may create a rescission right in favor of the purchasers, potentially requiring the seller to repurchase the securities sold, plus interest (and attorneys fees in some states). In essence, the transaction becomes a sale of securities by a person not licensed to consummate the sale, so the sale of the company is voided. A buyer which successfully asserts this claim has the right to demand that the purchase contract for the company be rescinded and require the issuer company (the seller) to return its funds. Under federal law, this rescission right can be exercised within one year after the discovery that such sale or purchase involves such violation and within three years after such violation. So a buyer would have few worries about any agreement terms whatsoever, because if the deal did not work out, the buyer could just rescind it.

In addition, many states have their own regulations regarding the licensing of M&A advisors, with California being particularly onerous. For sellers and buyers located in California, for example, a rescission right is explicitly available pursuant to the California Corporations Code. This section also provides that the purchaser can seek damages if he or she no longer owns the security, and gives the court discretion to award a plaintiff seeking rescission attorney fees and costs. Also in California, even the sale of assets of a company requires certain licensing. Specifically, the sale of all "business opportunities" in the state fall under the purview of the California Real Estate Commission, so persons selling

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## RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS

Announce Date	Acquirer/Investor(s)	Target	Target Description
10/28/2011	Keystone Automotive Operations	NTP Distribution, Inc.	a privately held provider of aftermarket products, parts and accessories for dealers in the RV and towing industries based
10/28/2011	QAP Automotive Industries	G.K. Industries	a North American aftermarket distributor of specialty automotive filtration products
10/26/2011	Standard Motor Products	Forecast Trading Corp.	distributes a range of engine management products including ignition coils, ignition modules, switches and sensors and filters
10/15/2011	Hopkins Manufacturing	Mr. Funnel	makes a line of portable fuel filters, designed to filter out contaminants when fuel is transferred from a portable container into a vehicle's tank
10/14/2011	Heidts Automotive Group	Alston Racing	manufacturers that actually builds complete race cars, from which its extensive parts business evolved
10/13/2011	Monro Muffler Brake	Terry's Tire Town	six regional retail locations
10/7/2011	Atlas Copco Tools	SCA Schucker	manufactures adhesive and sealant equipment, a relatively large niche segment with few global specialized players
10/7/2011	LKQ Corp.	Euro Car Parts (ECP)	the largest distributor of automotive aftermarket parts in the United Kingdom
10/7/2011	Taylor Cable Products	Percy's High Performance	products, including Seal 4 Good exhaust gaskets and Adjust-A-Jet metering blocks. Other products, including a Split Lock line and SpeedGlass racing windshields, are under review
10/7/2011	Fisher Auto Parts	McLaughlin Automotive Stores	eight stores and a warehouse serving customers across Rhode Island
10/6/2011	Henniges Automotive	Nomaseal	an automotive industry supplier of weatherseals. The company has a manufacturing facility in Hranice, Czech Republic, and a sales and technical center in Viersen, Germany.
10/3/2011	Johnson Controls	Johnson Controls-Saft	a joint venture which was formed in 2006 to develop and manufacture Li-ion vehicle batteries
10/3/2011	Defa S.A.	Trelleborg (gas spring operation)	Trelleborg's gas spring operation located in France
9/27/2011	Fabco Holdings Inc. (Wynnchurch Capital)	Fabco Automotive Corp. (Accuride Subsidiary)	produces steering drive axles, transfer cases, split shaft power take offs and other specialty products for the commercial severe-duty industry
9/26/2011	Genuine Parts Co.	Exego Group (30% stake)	a leading aftermarket distributor of automotive replacement parts and accessories in Australasia

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the assets of a company in that state must at least have a California real estate license.

Even if rescission is not demanded, the use of an unregistered broker-dealer could create disclosure requirements in subsequent financings, acquisitions, or offerings. SEC filings require disclosure of compensation paid to finders in connection with an offering. Such disclosure may dissuade future investors from investing and may prevent legal counsel from being able to issue required legal opinions in connection with a subsequent financing. In addition, failing to disclose payments made to unregistered broker-dealers in connection with the sale of securities can expose a company to potential liability for fraud under the Securities Act.

In summary, if a business owner has a success fee arrangement (usually a % of the sale price) with an intermediary assisting in the sale of the *stock* of his company, the owner should consider using a registered broker dealer. If not, the purchaser may have three years to rescind the deal.

### **Void exemptions**

Each securities transaction needs to be registered under federal and state law unless exempted. Using an unregistered broker can increase the probability that the transaction will not be exempt.

- Many states' exemptions from the registration requirement are conditioned on the issuer not using an unregistered broker. If Rule 506 of the Act is not used or becomes unavailable (because it later turns out that all of the rule's conditions were not met), the

use of an unregistered broker in the transaction may render the transaction in violation of state securities offering registration requirements.

- Brokers who shun registration requirements may be more likely to ignore other legal requirements, such as not conducting securities offerings in a manner that is deemed to be a public solicitation, and therefore eliminate the seller's ability to rely on exemptions.

### **Direct violation of state law**

Independent of what exemption is used at the state level for sale of a security, many states' laws specifically prohibit the use of an unregistered broker by an issuer of securities. Further, issuers of securities can face liability under both federal and state law for knowingly aiding and abetting violations by unregistered brokers.

### **Lose the supervision of the registered broker**

Running your M&A transaction or capital raise through a registered broker provides many benefits, including:

- Provides comfort to purchasers and other deal participants that the deal does not have the taint of an unregistered participant;
- May add to the issuer/seller's legitimacy, as deal participants and purchasers know that the registered broker has vetted the issuer and the offering; and
- The registered broker's supervision of its representatives' activities in selling the securities adds a layer of protection to all parties, including the seller/issuer.

#### *Disclaimer*

*The contents of this newsletter should not be considered legal advice. Please consult an attorney with relevant experience.*

## **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.

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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 10/31/11	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	Net Income
<b>Manufacturers</b>									
Federal-Mogul Corporation	\$16.86	\$1,667.5	\$2,834.0	\$931.0	\$3,669.5	9/30/11	\$6,844.0	\$645.0	\$198.7
Tenneco Automotive, Inc.	32.72	1,972.9	1,304.0	163.0	3,220.3	9/30/11	6,998.0	583.0	115.7
Dorman Products, Inc.	38.11	687.9	3.8	45.6	669.1	9/24/11	512.8	86.8	48.9
Standard Motor Products, Inc.	15.55	352.0	42.1	14.9	380.0	9/30/11	873.4	78.9	38.0
<b>Wholesalers &amp; Distributors</b>									
Genuine Parts Company	\$57.43	\$8,939.2	\$500.0	\$534.8	\$9,024.9	9/30/11	\$12,252.5	\$980.4	\$548.8
LKQ Corporation	29.18	4,277.1	632.6	45.1	5,054.6	9/30/11	3,004.3	399.2	202.0
The Coast Distribution System, Inc.	2.71	12.3	12.7	2.8	22.2	6/30/11	107.8	0.3	(1.1)
<b>Retailers</b>									
Autozone, Inc.	\$323.59	\$13,448.6	\$3,351.7	\$97.6	\$17,205.7	8/27/11	\$8,073.0	\$1,691.0	\$849.0
Advance Auto Parts, Inc.	65.07	4,797.9	566.4	68.8	5,453.1	7/16/11	6,054.5	776.5	358.4
O'Reilly Automotive, Inc.	76.05	9,759.4	797.8	276.7	10,762.9	9/30/11	5,707.8	987.9	499.1
The Pep Boys - Manny, Moe & Jack	11.50	605.8	295.7	62.0	845.1	7/30/11	2,009.9	158.1	40.5
US Auto Parts Network, Inc.	5.60	171.5	19.4	15.2	175.8	10/1/11	330.3	7.2	(11.0)

**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>									
Federal-Mogul Corporation	0.5x	10.7x	5.7x	13.2x	18.5x	8.4	15.8%	9.4%	2.9%
Tenneco Automotive, Inc.	0.5x	8.6x	5.5x	8.2x	27.8x	17.1	16.4%	8.3%	1.7%
Dorman Products, Inc.	1.3x	8.5x	7.7x	9.9x	13.7x	14.1	36.2%	16.9%	9.5%
Standard Motor Products, Inc.	0.4x	5.9x	4.8x	5.4x	10.0x	9.3	25.9%	9.0%	4.3%
<b>Mean</b>	<b>0.7x</b>	<b>8.4x</b>	<b>5.9x</b>	<b>9.2x</b>	<b>17.5x</b>	<b>12.2x</b>	<b>23.6%</b>	<b>10.9%</b>	<b>4.6%</b>
<b>Median</b>	<b>0.5x</b>	<b>8.5x</b>	<b>5.6x</b>	<b>9.1x</b>	<b>16.1x</b>	<b>11.7x</b>	<b>21.2%</b>	<b>9.2%</b>	<b>3.6%</b>
<b>Wholesalers &amp; Distributors</b>									
Genuine Parts Company	0.7x	10.1x	9.2x	10.1x	16.4x	16.3	28.8%	8.0%	4.5%
LKQ Corporation	1.7x	14.4x	12.7x	16.1x	25.0x	21.2	42.9%	13.3%	6.7%
The Coast Distribution System, Inc.	0.2x	NM	NM	NM	NM	NM	16.9%	0.3%	NM
<b>Mean</b>	<b>0.9x</b>	<b>12.3x</b>	<b>10.9x</b>	<b>13.1x</b>	<b>20.7x</b>	<b>18.7x</b>	<b>29.5%</b>	<b>7.2%</b>	<b>5.6%</b>
<b>Median</b>	<b>0.7x</b>	<b>12.3x</b>	<b>10.9x</b>	<b>13.1x</b>	<b>20.7x</b>	<b>18.7x</b>	<b>28.8%</b>	<b>8.0%</b>	<b>5.6%</b>
<b>Retailers</b>									
Autozone, Inc.	2.1x	11.5x	10.2x	12.6x	20.3x	15.8	51.0%	20.9%	10.5%
Advance Auto Parts, Inc.	0.9x	9.0x	7.0x	10.4x	15.2x	13.4	50.0%	12.8%	5.9%
O'Reilly Automotive, Inc.	1.9x	13.1x	10.9x	16.4x	21.6x	19.6	48.7%	17.3%	8.7%
The Pep Boys - Manny, Moe & Jack	0.4x	10.4x	5.3x	10.0x	20.9x	15.0	25.9%	7.9%	2.0%
US Auto Parts Network, Inc.	0.5x	NM	NM	NM	NM	NM	33.5%	2.2%	NM
<b>Mean</b>	<b>1.3x</b>	<b>11.0x</b>	<b>8.4x</b>	<b>12.3x</b>	<b>19.5x</b>	<b>15.9x</b>	<b>41.8%</b>	<b>12.2%</b>	<b>6.8%</b>
<b>Median</b>	<b>1.4x</b>	<b>11.0x</b>	<b>8.6x</b>	<b>11.5x</b>	<b>20.6x</b>	<b>15.4x</b>	<b>49.4%</b>	<b>15.1%</b>	<b>7.3%</b>

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

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful