

the aftermarket analyst

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

Options for Underperforming Aftermarket Companies

Our recent webinar, "Options for Underperforming Companies in the Automotive Aftermarket," discussed industry, demographic and capital markets trends, as well as financial options that are currently available. Though most fundamentals for the automotive aftermarket have been trending downward, the industry remains fairly stable vis-à-vis other industries. Investors are still keen on many segments and see signs of recovery. Below are a few of the variables which determine the fundamental strength of the aftermarket.

Miles Driven – Down roughly 2% since 2007, this is a particularly important statistic for manufacturers of "hard parts" as changes in miles driven equate to fluctuations in service and repair needs.

New Vehicle Registrations – This is also currently trending downward as would be expected given the declines in new vehicle sales. Declining new vehicle registrations negatively impact many aftermarket accessory manufacturers, as most accessories are purchased within 12 months of a vehicle's purchase.

Age of Vehicles - Given the challenging economic environment and subsequent declining new car sales, age of vehicles is increasing. Consumers are holding on to their current automobiles and foregoing upgrades unless necessary. This increasing age of vehicles benefits hard parts manufacturers, as these older vehicles are no longer under warranty and require more repair with age.

Gas Prices – Increased gas prices negatively affect new vehicle sales, especially light trucks. Additionally, increased gas prices lead to decreasing miles driven. In short, increasing gas prices hamper the automotive aftermarket.

Owners and management teams of struggling aftermarket businesses often want us to present their financial options, which we did in the webinar. While the answer is unique to each company, some basic financial options for underperforming companies are:

1. **Maintain Status Quo** – This option is simply the continued implementation of the company's existing strategic plan. It is primarily for companies that have made it through the current economic crisis relatively unscathed and can handle the possibility of depressed earnings through 2010. With the slow season upon the aftermarket and timetable for economic recovery uncertain, this approach must be coupled with a detailed 2010 forecast that includes a "worst case" scenario.
2. **Raise Senior Debt** – Senior Debt has traditionally been comprised of asset-based and cash flow based financing. Today, cash flow financing is no longer an option as banks require more tangible collateral. However, depending upon a company's capital structure and fixed assets, asset based financing may be an attractive option.

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RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS

Announce Date	Acquirer/Investor(s)	Target	Target Description
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	Iochpe-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.
7/14/2009	FleetPride	Fleet Supply of Tallahassee Inc.	an independent aftermarket distributor of heavy-duty truck and trailer parts serving Florida and the panhandle
7/9/2009	CoverCraft	Global Accessories, Inc.	purchased most of the assets including the lines Wolf Automotive, Powersports and Marine covers; LeBra front-end covers; DashMat dashboard covers; Premier Floor Mats; and Spidy Gear cargo web products
7/6/2009	Uview	MotorVac Technologies	supplies professional automotive fluid maintenance equipment and service products that are distributed to more than 60 countries
7/3/2009	OpenGate Capital	ArvinMeritor	ArvinMeritor has sold the U.S. portion of its Gabriel ride control products business to OpenGate Capital
7/3/2009	Management buyout	Thule - Valley Towing Systems	the management team of Valley Towing Systems has purchased the Lodi, CA-based company from its former parent, Thule

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3. **Raise Subordinated Debt** – Subordinated debt, or mezzanine financing, is available and can take many forms. This debt is secured by a second claim on the company's assets. Mezzanine lenders typically require warrants as part of the financing allowing them to benefit from an increase in the value of the company's equity in the future. Mezzanine debt has increased in the last 12 – 18 months as more "traditional" funding sources have dried up.
4. **Minority Equity Investment** – This investment in a company's common or preferred shares is usually effected by a Private Equity Group (PEG). Minority equity has become increasingly popular as PEGs face difficulty obtaining or refinancing acquisition debt. This also serves as a good way for PEGs to become familiar with an industry or sector while limiting exposure. Additionally, some PEGs are devoted solely to minority investments as they lack the expertise to successfully operate the business.
5. **Majority Equity Investment** – A majority equity investment, or recapitalization ("recap"), often involves 60-80% of a company's stock.
6. **Buyout** – Involving 100% of outstanding shares or assets, buyouts are usually favored by strategic players. It is sometimes the only option for a company whose debt equals its enterprise value.
7. **Merger** – A combination of two or more entities into one, mergers are becoming more popular as a means to gain competitive advantages in the market. Mergers often result in decreased operating expenses (overhead, SG&A, etc.) and increased revenue through expanded distribution.
8. **Roll-up** – Similar to the merger concept, several entities are "rolled up" into one entity. Owners accept valuation as % of the new entity. Financial buyers will use this option as a means to gaining economies of scale. Roll-ups tend to occur more often in challenging economic environments.
9. **Debt Restructuring** – Due to difficulties with repayment or not adhering to lender covenants, many aftermarket companies have found themselves dealing with a bank's workout department. Experienced workout departments will quickly determine the value, if any, of their underlying collateral position. Many loans are collateralized by assets where the liquidation value is significantly less than the loan balance. We have found that most lenders are interested in working with companies to ensure a good outcome for both parties. Whether this means decreasing the amount of the loan ("haircut"), arranging more favorable payment terms, or swapping equity for a portion of the outstanding debt, many experienced lenders are willing to work with their clients.
10. **Bankruptcy** – This option is best viewed as a last resort. Chapter 11 is voluntary bankruptcy filing. Chapter 7 is a liquidation of the assets. While many erroneously view Chapter 11 as a panacea of their company's ills, it is estimated that more than 90% of Chapter 11 filings fail, leading to a Chapter 7 liquidation.

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)			Net Income	
	Price as of 9/30/09	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue		EBITDA
Manufacturers									
Federal-Mogul Corporation	\$12.07	\$1,199.8	\$2,862.2	\$687.3	\$3,431.7	6/30/09	\$5,553.1	\$381.6	(\$239.3)
ATC Technology Corporation	19.76	392.3	70.0	99.0	363.3	6/30/09	497.3	69.3	22.7
Tenneco Automotive, Inc.	13.04	616.6	1,520.0	111.0	2,048.6	6/30/09	4,778.0	231.0	(439.8)
Dorman Products, Inc.	15.02	264.9	10.9	4.5	278.8	6/30/09	354.6	40.3	20.7
Standard Motor Products, Inc.	15.20	290.2	136.0	14.5	412.7	6/30/09	721.5	34.0	5.9
Wholesalers & Distributors									
Genuine Parts Company	\$37.68	\$6,011.1	\$500.0	\$238.6	\$6,272.5	6/30/09	\$10,381.8	\$792.6	\$411.6
LKQ Corporation	18.54	2,599.3	636.6	129.5	3,233.8	6/30/09	1,971.7	236.1	102.4
The Coast Distribution System, Inc.	3.63	16.2	11.5	2.6	25.1	6/30/09	107.9	(2.4)	(2.3)
Retailers									
Autozone, Inc.	\$146.22	\$7,857.0	\$2,405.9	\$94.3	\$10,344.7	5/9/09	\$6,663.6	\$1,332.4	\$656.7
Advance Auto Parts, Inc.	39.28	3,749.2	279.6	126.4	3,918.5	7/18/09	5,386.8	582.5	254.5
O'Reilly Automotive, Inc.	36.14	4,902.6	796.6	41.0	5,781.0	6/30/09	4,641.0	543.7	239.5
The Pep Boys - Manny, Moe & Jack	9.77	511.2	309.4	21.9	798.7	8/1/09	1,915.1	76.1	(20.8)
US Auto Parts Network, Inc.	5.45	162.7	0.0	32.6	130.1	6/30/09	153.8	3.0	(4.0)

Selected Public Company Multiples and Operating Statistics

Company	Enterprise Value /				Net Income	P / E Ratio	Margins		
	Revenue	EBIT	EBITDA	Free Cash Flow (2)			Gross Margins	EBITDA Margins	Net Margins
Manufacturers									
Federal-Mogul Corporation	0.6x	76.3x	9.0x	28.3x	NM	NM	14.7%	6.9%	NM
ATC Technology Corporation	0.7x	6.6x	5.2x	5.8x	16.0x	17.3	22.0%	13.9%	4.6%
Tenneco Automotive, Inc.	0.4x	146.3x	8.9x	34.7x	NM	NM	14.3%	4.8%	NM
Dorman Products, Inc.	0.8x	8.5x	6.9x	8.4x	13.5x	12.8	32.6%	11.4%	5.8%
Standard Motor Products, Inc.	0.6x	21.8x	12.2x	16.6x	69.5x	48.9	23.8%	4.7%	0.8%
Mean	0.6x	51.9x	8.4x	18.8x	33.0x	26.3x	21.5%	8.3%	3.7%
Median	0.6x	21.8x	8.9x	16.6x	16.0x	17.3x	22.0%	6.9%	4.6%
Wholesalers & Distributors									
Genuine Parts Company	0.6x	8.9x	7.9x	9.0x	15.2x	14.6	29.6%	7.6%	4.0%
LKQ Corporation	1.6x	16.2x	13.7x	18.3x	31.6x	25.4	44.1%	12.0%	5.2%
The Coast Distribution System, Inc.	0.2x	NM	NM	NM	NM	NM	17.4%	NM	NM
Mean	0.8x	12.5x	10.8x	13.6x	23.4x	20.0x	30.4%	9.8%	4.6%
Median	0.6x	12.5x	10.8x	13.6x	23.4x	20.0x	29.6%	9.8%	4.6%
Retailers									
Autozone, Inc.	1.6x	8.9x	7.8x	9.6x	15.8x	12.0	50.1%	20.0%	9.9%
Advance Auto Parts, Inc.	0.7x	9.0x	6.7x	9.5x	15.4x	14.7	48.8%	10.8%	4.7%
O'Reilly Automotive, Inc.	1.2x	13.2x	10.6x	60.1x	24.1x	20.5	46.7%	11.7%	5.2%
The Pep Boys - Manny, Moe & Jack	0.4x	NM	10.5x	21.1x	NM	NM	24.3%	4.0%	NM
US Auto Parts Network, Inc.	0.8x	NM	43.1x	NM	NM	NM	35.6%	2.0%	NM
Mean	1.0x	10.4x	15.7x	25.1x	18.4x	15.7x	41.1%	9.7%	6.6%
Median	1.0x	9.0x	10.5x	15.3x	15.8x	14.7x	47.7%	11.3%	5.2%

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

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful