

Grant Thornton Corporate Finance

mergers & acquisitions



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Grant Thornton Corporate Finance Mergers & Acquisitions

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Automotive aftermarket: M&A activity likely to continue as private equity interest and margin pressure drive transactions

Industry background

- The U.S. automotive aftermarket, a more than \$250 billion dollar industry, is both large and highly fragmented¹.
- Auto parts aftermarket sales growth prospects remain promising.
 - The U.S. motor vehicle aftermarket has grown at a 4.0 percent compound annual growth rate (CAGR) since 2000.
 - The majority of aftermarket auto part manufacturing sales are to the do-it-for-me (DIFM) segment, which is largely insulated from downturns in the economy.
 - Several industry dynamics are coming together to favorably impact aftermarket sales prospects: The number of registered vehicles has increased, the average age of vehicles is up to 9.1 years², and automobiles are driven for more miles than in the past.
- Automotive parts manufactures continue to feel pressure from abroad
 - As production moves overseas, we have seen the U.S. trade deficit in automotive parts expand to a record \$30.8 billion in 2004².
- The number of automotive parts manufacturers continues to decrease. Overall, it is expected that of the nearly 800 major domestic parts suppliers in 2000, fewer than 100 will still be around by 2010².

Auto aftermarket M&A activity

- The last twelve months through Sept. 30, 2005, there have been 50 automotive products M&A transactions. This is a decrease of roughly 17 percent as compared to the same period last year.
 - Strategic consolidations continue to account for the majority of automotive supplier M&A transactions.
- Private equity players continue to pursue automotive aftermarket companies.
 - American Capital Strategies, The Carlyle Group, First Atlantic Capital, Heritage Equity, Platinum Equity, Sun Capital Partners, and Thayer Capital Partners are a few of the private equity names appearing in 2005 on the buyer side.

¹Automotive Aftermarket Industry Association

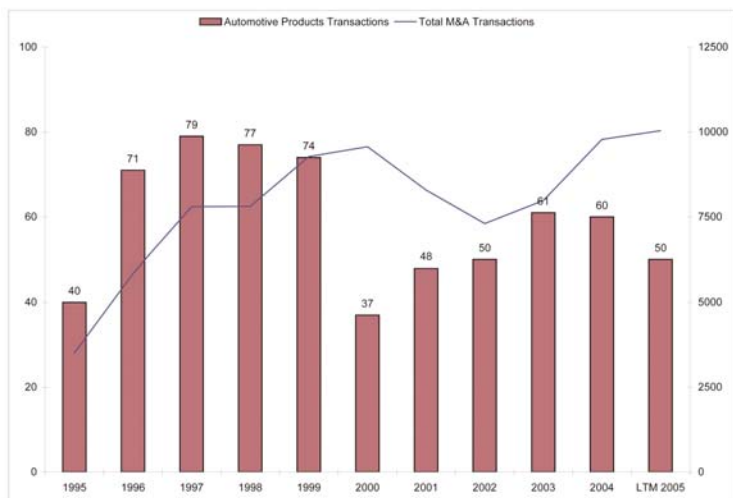
²U.S. Department of Commerce: U.S. Automotive Parts Industry 2005 Annual Assessment

In analyzing automotive products M&A activity over the past ten years, we see two distinct peaks in transaction activity. Currently, it appears that the automotive products sector is trailing off of the increased activity levels of 2003 and 2004. This trend counters the overall upwards movement in total M&A market activity since 2002. We believe that increases in overall market activity in combination with the highly fragmented nature of the automotive aftermarket supplier base will counteract any further decreases in the number of automotive products M&A transactions.

We believe that it is only logical for the automotive aftermarket segment to follow suit with the OEM segment and both rationalize the supplier base as well as relocate production abroad. We recognize that the two segments have different dynamics. For example, an OE supplier has on average four customers and sells 100,000 units per customer, where as an aftermarket supplier has a couple of thousand customers and sells 10 units to each². However, the manufacturing behind the products are too similar to overlook, leading us to believe that aftermarket manufacturers may be tied to trends affecting the OEM side after all.

"According to some industry observers, the whole aftermarket parts manufacturing base should be rationalized, consolidated and put together and separated from OE suppliers."
 – U.S. Department of Commerce

Table One - Automotive Products Transactions 1995 - LTM 2005



Source: Mergerstat

Note: Last twelve months through September 30, 2005

M&A activity

On page three, table two highlights specific recent automotive aftermarket M&A transactions, with a focus towards those with disclosed financial terms.

- Overall, precedent automotive aftermarket manufacturers have sold for a median 0.8x trailing twelve months revenue.
- Recent 2005 M&A transactions highlight the degree of aftermarket manufacturer specialization. With transactions across products ranging from spark plugs to high-performance wheels, fragmentation in the supplier base is evident.

Aftermarket transaction drivers

- Margin pressure is forcing consolidations
 - Delphi's booming Asian operations segment highlights the attraction to moving operations overseas. At labor costs in China of roughly \$3/hour versus the fully loaded \$65/hour in the U.S, it is only a matter of time before the aftermarket follows suit and relocates manufacturing abroad.
 - Increased customer purchasing power, as OEM suppliers, mass merchandisers and auto parts retailers continue their own consolidations, is further squeezing aftermarket parts manufacturers.
- Increasing steel prices and energy costs are hampering profitability and continue to drive less financially sound suppliers into bankruptcy.

- Currency markets favor cross-border acquisitions
 - Strong Euro and Asian currency values versus the dollar provide foreign companies with both a competitive advantage against domestic bidders as well as cheaper relative transaction values.
 - Opportunity for foreign manufacturers to expand their global footprint through acquisitions into the U.S. supplier base.
- With fewer strategic acquirers in the market today, private equity plays should remain prevalent within the sector.

Public company comparables

Automotive aftermarket manufacturing public companies currently trade at a median valuation of 7.9x trailing twelve month EBITDA. Excluding Standard Motor Products Inc, we view the adjusted median valuation of 6.9x trailing EBITDA as more relevant. The median enterprise value to revenue multiple of 0.7x is in line with the actual transaction multiples we have seen acquirers pay within the sector. Both Aftermarket Technology Corp. and R&B Inc. have posted strong, double-digit operating margins, which are reflected in their higher trading levels as compared to trailing twelve month revenue.

- Standard Motor Products' and Proliance International's lower profitability levels driving lower enterprise value to revenue valuations suggest an opportunity for multiple expansion. At valuations of 0.5x - 0.6x revenue, these two companies highlight an opportunity for pursuing acquisitions of underperforming aftermarket suppliers.

Table Two - Selected Automotive Aftermarket precedent transactions

Ann. Date	Target	Description	Acquiror	Transaction		TV / LTM	
				value (\$mm)	Sales	EBITDA	
07/18/05	American Racing Equipment, Inc.	High-performance wheels to automotive aftermarket	Platinum Equity	\$41	NA	NA	
07/15/05	Tractech Inc.	Manufacturer of differentials and clutch components	Eaton Corp.	\$54	1.3x	NA	
06/10/05	The Automotive Edge / Hermoff	Manufacturer of exhaust components and catalytic converters	R&B Inc.	\$2	NA	NA	
04/18/05	Autotronic Controls Corp. (MSD Ignition)	Manufacturer of multiple spark discharge products	ValueAct Capital	\$141	1.4x	7.8x	
03/31/05	Beck/Arnley Worldparts Corp.	Supplier of import parts to the automotive aftermarket	Heritage Equity Group	NA	NA	NA	
02/25/05	Unit Parts Co.	Alternators and starters to the automotive aftermarket	Remy International	\$55	0.4x	NA	
01/31/05	Modine Manufacturing Co.	Merger of aftermarket business into Transpro	Transpro Inc.	NA	NA	NA	
12/22/04	Qualitor, Inc.	Brake components, wipers, engine control and heavy-duty parts	Thayer Capital, Baird, American Capital	\$180	1.0x	NA	
11/05/04	Pace Edwards Co.	Manufacturer of retractable tonneau covers	Truck Accessories Group	\$10	0.6x	NA	
07/09/04	Dana Corp - Automotive Aftermarket Group	52 facilities, replacement product brands and components	The Cypress Group	\$1,100	0.6x	NA	
06/25/04	Edelbrock Corp.	Replacement parts for automotive and motorcycle aftermarket	Victor Edelbrock	\$82	0.6x	7.3x	
05/28/04	Qualis Automotive LLC	Supplier of brake and chassis products to aftermarket	HKW; MassMutual; MacLean-Fogg	NA	NA	NA	
05/01/03	United Components, Inc.	Diversified automotive parts manufacturer	The Carlyle Group	\$800	0.9x	6.0x	
02/24/03	Highland Group Industries, Inc.	Cargo management and vehicle protection products	TriMas Corp.	\$71	1.4x	NA	
02/10/03	Dana Corp - Engine Management	Engine management products for automotive aftermarket	Standard Motor Products	\$120	0.4x	NA	
02/07/03	Dayton Parts, LLC	Manufacturer of undercarriage replacement parts	Gen Cap America	\$19	NA	NA	
				Mean	0.9x	7.0x	
				Median	0.8x	7.3x	

Source: Company filings and press releases



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Conclusion

M&A activity within the automotive aftermarket parts sector, although fewer transactions than in past years, remains a consistently active market. Healthy aftermarket suppliers are receiving higher valuations by the public market, indicating an opportunity for turn-around acquirers to capitalize on multiple expansion. Private equity remains an active participant in sector transactions.

Table Three - Public Company Trading Valuation Multiples

Company Name	Ticker	Market Cap. \$MM	Enterprise Value \$MM	EV/ TTM Sales	EV/TTM EBITDA	EBITDA Margin
Standard Motor Products Inc.	SMP	\$169	\$456	0.6x	13.9x	4.0%
Aftermarket Technology Corp.	ATAC	\$363	\$447	1.1x	6.9x	15.7%
R&B Inc.	RBIN	\$194	\$233	0.9x	6.9x	13.0%
Proliance International, Inc.	PLI	\$74	\$125	0.5x	8.8x	5.3%
Median				0.7x	7.9x	9.2%

Source: Capital IQ; Stock Prices as of October 17, 2005

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