AUTOMOTIVE ACCESSORIES AFTERMARKET
DEAL THESIS FOR PRIVATE EQUITY ACQUISITION

Online Retail Continues to Explode…

Well documented, the Holiday sales trend during the final months of 2012 only reaffirmed the increasing impact of e-commerce on the retail landscape. According to ShopperTrak, online sales grew by 15% from November 1 - December 31, compared to the same two-month period during 2011. comScore, Inc. is slightly more conservative, pegging this increase at 13.7%, which translates to total online spend during period of $42.3 billion online. Contrast this with sluggish store sales growth of 2.5-3.7% (numbers vary among estimates provided by ShopperTrak, shopping center trade organization ICSC, and comScore, respectively), and the trend becomes even more pronounced.

In the words of Frank Badillo, senior economist at Kantar Media, which publishes data on traffic and spending, "Online sales continue to take away from stores. They continue to post double-digit growth while store sales are flat or only slightly increase."

Reviewing 12 months of data for 2011 provides additional validation. According to the U.S. Department of Commerce and *Internet Retailer* (June 2012 issue), total e-commerce sales grew from $167.3 billion to $194.3 billion from 2010-2011, an increase of 16.14%. Firms occupying the *Internet Retailer* Top 500 grew at an even stronger rate (17.8%), and represented more than 2/3 of the total online sales generated during the year ($131.2 billion, or 67.5%). Amazon, in fact, generated sales growth of 40.6% during 2011. Remove the impact of this juggernaut, and the Top-500's 17.8% growth would decline to 14.4%. Though not yet available, annualized data for 2012 are expected to depict a very similar picture.

Beyond Amazon, whose technological prowess and product assortment are unsurpassed, two other companies exemplify the types of companies whose impact on e-commerce is immeasurable. Walmart's economies of scale allows its bricks-and-mortar and Walmart.com entities to essentially impose their will on retail pricing strategies across many categories. Likewise, eBay's technology focus is steadily expanding its online impact, as it morphs more toward non-auction retail (with "buy it now" garnering greater percentages of its retail sales), and by increasing its competitiveness in the emerging mobile and tablet-commerce sub-channels of e-retailing, two areas of online commerce that are barely in their infancies.

Clearly, increasing consumer acceptance of online retail as a channel—which can be linked to their fondness for technology, as well as the convenience and product assortment that is often unparalleled in the offline world—is a key driver behind retailing's most significant growth opportunity.

…But a Key Challenge Remains

Therein lies the crux of online retail. While the channel itself and the consumer's acceptance of this shopping alternative are thriving, five principal macroeconomic factors must be addressed for an online or multichannel retail business to thrive:

- Large-scale competition is challenging margins
- Aggressive pioneers and mass merchants offer substantial product depth and breadth
- Scale and technology investments consistently raise the bar for speed of fulfillment
- Consumer expectations of social media and the overall user experience also require expertise and investment
- Products, websites, and positioning are becoming increasingly commoditized

On the flipside, however, there is increasing consumer resistance to mass merchandisers, and this is also at the core of my thesis:

> *<u>The marketplace is creating new opportunities to build significant, profitable businesses that will thrive across a highly-competitive landscape that is increasingly dominated by large-scale companies. Strategic positioning, however, is no longer optional. These enterprises must be sufficiently differentiated and able to cost-effectively target and serve meaningful customer segments. To grow, these businesses also require a mindset that that blends entrepreneurship, analytics, and corporate best practices.</u>*

Market Overview, Competition and the *Internet Retailer* Top 500

In the U.S., four leading automotive specialty chains—Advance Auto Parts, AutoZone, O'Reilly Automotive, and Pep Boys—are prominent, with each generating annual sales ranging from $2 billion (Pep Boys) to more than $7 billion (AutoZone). Each operates online businesses, though none has achieved the type of prominence that often accompanies the resources of a multibillion dollar enterprise. CarQuest and NAPA are also prominent.

Freedonia Group forecasts annual revenue growth in the automotive aftermarket of 3.2% from 2012 - 2016, reaching $85 billion. The firm cites the "expansion in size and increasing age of the North American light vehicle fleet." They also note that the prime aftermarket service age for many components (5-10 years) is highly represented among today's vehicles.

From an online perspective the 2012 *Internet Retailer* Top 500, which incorporates publicly available or privately reported data from 2011, includes nine websites with strong assortments in the automotive (or motorcycle) aftermarket. Although a number of companies and websites are not included in this survey, the list provides an interesting strategic backdrop.

Under "Strategic Positioning," I have included a brief description of each company's go-to-market approach. In addition, Amazon and Walmart.com are included for illustration purposes:

Rank	Company/Website	2011 Online Revenue	2011 Growth	Strategic Positioning
1	Amazon	$48.1 billion	40.6%	Juggernaut
4	Walmart.com	$4.9 billion	19.7%	Juggernaut
76	U.S. Auto Parts Network	$327.1 million	24.7%	Roll-up*
121	AutoZone.com	$183.0 million	9.5%	Retail chain
157	AutoAnything	$111.9 million	13.9%	Niche*
186	Motorcycle Superstore	$94.0 million	32.4%	Niche*
292	Turn5, Inc.	$42.0 million	5.5%	Niche*
300	J&P Cycles	$40.5 million	35.0%	Niche*
385	Advance Auto Parts	$26.5 million	17.6%	Retail chain
415	BuyAutoParts.com	$23.0 million	9.3%	Online parts superstore
433	DiscountRamps.com	$20.7 million	16.9%	Niche*

A quick overview of six Top 500 companies provides insight into a key component of automotive aftermarket success. As shown above, five have successfully created models that can be categorized as "niche" businesses:

- Publicly-traded U.S. Auto Parts (NASDAQ: PRTS) includes USAutoParts.net, JCWhitney.com, AutoPartsWarehouse.com, PartsTrain.com, StylinTrucks.com, and content/social media site AutoMD.com. Based on its Q3, 2012 release, the company has recently experienced soft/decreasing sales due to "headwinds with respect to customer acquisition and online traffic," according to CEO Shane Evangelist." It is also important to note that the company's gross margins of 31.4% (Q3, 2012) reflect an aggressive mass merchant type of approach.
- AutoAnything (AutoAnything.com) is a prominent, differentiated multichannel retailer with its roots in the catalog industry. Its product offering includes a broad and deep assortment of accessories to complement its parts offerings.
- Motorcycle Superstore (MotorcycleSuperstore.com), Turn5 (AmericanMuscle.com), and J&P Cycles (JPCycles.com) are three excellent examples of retailers that have chosen to go forward with distinct and focused product offerings. The AmericanMuscle.com site offers a comprehensive selection of Mustang accessories, while Motorcycle Superstore and J&P provide strong assortments of motorcycle parts and accessories.
- The DiscountRamps.com site is also laser-focused, attempting to be the authority in the loading, hauling, and transport categories across such markets as auto, truck, ATV, snowmobile, marine, and trailering.

Another interesting business, though not included above, is MacNeil Automotive of Bolingbrook, IL (WeatherTech.com). This company has established a high-quality brand of automotive products (primarily interior accessories such as premium floor mats) by selling direct to the consumer, as well as through leading online and offline retailers. To this point, they have also demonstrated their ability to minimize channel conflict, an approach that is essential if acquiring a strong B2B play.

My Vision

While underscoring the obvious scale issues of those that I refer to as "juggernauts" and retail chains, the *Internet Retailer* survey and other continue to reinforce the attractiveness of a niche/highly focused merchant that is uniquely positioned.

My vision is to build a very different type of automotive accessories online/multichannel retailer that combines the feel of an "enthusiasts-first" business with the specialized expertise, strong product assortment (including many items that are either exclusive or unique), competitive prices (though not necessarily the lowest across-the-board), and quality fulfillment that will build customer lifetime value.

Key building blocks of this business will include:

- Skilled differentiation
- Strong branding
- Strategic sourcing
- Strategic alliances (to enhance differentiation, marketing, and customer acquisition)
- Nimble, flexible social media that will engage the consumer

As part of the go-forward plan, the bolt-on acquisition of smaller niche operators could also become a very viable strategy. In this space, as companies that lack management skills, scale, and uniqueness become increasingly prevalent, opportunities to cost-effectively acquire their revenue, customers, and new product lines or areas of product focus will follow. In fact, I actually communicated with one such company earlier this week.

CEO Background Combines Entrepreneurial and Public Company Skills

My background is uniquely tailored to this initiative for several reasons. Though I will not take the opportunity to review my resume in detail, I would like to share several diverse components that provided experience.

First, I bring the strong entrepreneurial and analytical skills that are required to thrive in this environment. Shortly after obtaining my M.B.A., I joined Overton's (Overtons.com) as its first full-time Marketing associate in 1988, with a simplistic job description to "grow the business and make the numbers work." Through 10 years in a dynamic, fast-paced environment that allowed me to pioneer new programs (with well-understood P&L accountability), we grew the multichannel business from $20 million to approximately $70 million through unique positioning strategies, innovative customer acquisition (including unique database-sharing agreements and our launch of Overtons.com ahead of the market in 1996), and strategic alliances with companies ranging from Federal Express, General Motors (Chevrolet) and Bombardier (Sea-Doo) to middle-market boat builders such as Mastercraft and Sea Ray. One of my objectives when joining the company was to establish Overton's as the marine and watersports industry's preeminent direct marketer. With several of our competitors boasting 100-200 retail stores apiece (we grew from two stores to four during my tenure), I believed strongly that this was essential to our growth and long-term survival.

Several years after I resigned from Overton's to pursue a restructuring opportunity and CEO role, these strategic programs and critical business discipline remained in place (due to multi-year contracts and other procedures). Their competitive advantages played major roles in the Company's private equity valuations, which ultimately led to several profitable exit events. One professional services executive, who was an integral part of one event, cited the inherent strength of these programs in driving the Company's enterprise value.

In 2000, I joined then-public Blair Corporation as the Executive Officer responsible for launching, leading, and building the company's E-Commerce division. Beginning with a 3-person department (including me), we grew the business from 0 to nearly $100 million in six years through leadership, organizational teaching, innovation, aggressiveness, and steadfast accountability for P&L, customer growth, and numerous strategic objectives. This new mindset transformed the company from one of a direct-mailer to one that the public markets would eventually recognize as an innovative direct marketer, not to mention a company that truly understood the emerging mindset of multichannel retailing. When shareholders approved our sale to Orchard Brands in a $173 million transaction, Blair's e-commerce prowess was clearly one of the strengths that drove this valuation.

Along with world class executive training and public market experience, my "newness" to Blair also reinforced my ability to excel in future roles by following a simple—yet thorough—approach to problem-solving:

- Assess new situations quickly and analytically
- Be objective
- Recognize proponents of the status quo
- Leverage the passion of those who will embrace change
- Create a vision and roadmap for the future
- Pay attention to details…and execute
- Do everything with integrity

During most of my Blair tenure, at least 80% of my executive officer peers had served the company for 30+ years, and I was the youngest officer on the team. This experience provided numerous large-scale "change agent" opportunities not only in E-Commerce, but also in Marketing (where I was promoted to design and lead a combined online and offline department), in Credit Management (where I was appointed by the CEO to correct a downward trend in customer performance), and in other leadership roles such as cost containment and restructuring (where I introduced and led several highly-profitable initiatives that were new to the organization).

Since leaving Blair, I have enjoyed successful management consulting, leadership and interim roles (including two CEO assignments) in manufacturing, financial services, consumer goods, and automotive aftermarket accessories. These provided new learning opportunities, successes in new markets, and expanded networking opportunities with several potential strategic partners. As CEO of RainEater, LLC during 2011—where I executed a stock sale as CEO—I earned the trust and built relationships with several external C-level executives who may provide unique strategic possibilities for this new enterprise. I also currently serve on the Board of an early-stage automotive product manufacturer (which markets an environmentally-friend penetrant/lubricant).

Exit Opportunity: Potential Acquirers

Despite an increasingly competitive marketplace and new requirements for success, the proper blend of management skills, operational excellence, market positioning, and strategy can be leveraged to build an online/multichannel automotive accessories business that will combine uniqueness, growth capabilities, and sufficient scale.

With strong execution, this business could be attractive to the following types of buyers:

- Automotive Accessories Chains
- Automotive Aftermarket Multichannel Retailers
- Automotive Aftermarket Online Retailers
- Non-Automotive Multichannel/Online Retailers
- Automotive Aftermarket Manufacturers/Distributors
- Private Equity Groups