

Dorman Products Inc.

| Nasdaq: DORM |

INVESTMENT RESEARCH REPORT

*"Out of Stock, Time to Part with Dorman"*

RECOMMENDATION: *Strong Sell*





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# About Spruce Point Capital Management

## Spruce Point Capital Is An Industry Recognized Research Activist Investment Firm Founded In 2009

- Founded by Ben Axler, a former investment banker with 17 years experience on Wall Street
- Ranked the #1 Short-Seller in the world by [Sumzero](#) after a comprehensive study of 12,000 analyst recommendations dating back to 2008 (March 2015)
- Ranked the #13 Most Influential FinTweeter on Twitter according to [Sentieo analysis](#) (Dec 2016)

## Track Record of Identifying Financial Schemes In The Auto and Transportation Sector

			
Report Date	<a href="#">1/15/14</a> (Prescience Point)*	<a href="#">7/13/17</a>	<a href="#">9/8/16</a>
Company Promotion	Best of breed recycled auto part distributor capable of effecting a roll-up strategy and producing consistent double digit revenue and EPS growth	Best of breed mirror “technology” company with world-leading gross margins capable of consistent double digit growth, achieving 90% market share, and effecting shareholder friendly policies	An effective roll-up acquirer in the third party logistics sector capable of extracting significant operating leverage and \$200-\$300m of revenue synergies from Command Transportation deal
Our Criticism	LKQ is an ineffective roll-up by a management team with a history of financial failure (Waste Management / Discovery Zone). LKQ is caught in a gross margin squeeze being masked by relentless acquisitions, and aggressive inventory accounting open to significant management judgement	Gross margins likely overstated by 2x through inventory and capex overstatement. CEO/Founder has stacked the Board with former insiders, internally promoted finance/accounting individuals, and former external auditor as Audit Committee chair to prevent detection of the financial scheme. Product test and newly released FOIA evidence exposes Gentex’s misstatements	Echo’s management team has a history of value destruction, its roll-up strategy was ineffective, its organic growth was approaching zero, and its GAAP/Non-GAAP accounting was signaling financial strain. We argued it paid a peak multiple for Command and would never hit its synergy targets. We estimated 50%-60% downside risk in ECHO’s shares
Successful Outcome	Gross margins have declined from over 47% to 39%. The company’s successive acquisition in Europe and domestically have failed to boost its share price. LKQ’s multiples have contracted significantly. Its CFO was replaced ( <a href="#">Feb 2015</a> ) and its CEO recently stepped down ( <a href="#">March 2017</a> )	<a href="#">7/21/17</a> : Gentex’s Q2’17 sales and earnings disappointment validate our concerns of a softening market. Significant gross margin contraction and admission by management that base mirrors carry 20% gross margins. Gentex’s share price fell 7.4% on earnings while executives did not address our concerns	In Q2’17 ECHO cut its FY17 revenue outlook and suspended longer-term guidance given changes in its end market and failure to hit synergy targets with Command. ECHO Sell-side brokers have finally downgraded their recommendations from Buy to Hold. ECHO’s shares fell to a 52 week low of \$13, nearly 50%

\* Reported produced by Prescience Point of which Spruce Point’s founder Ben Axler was a contributing author

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## *Executive Summary*



## *Spruce Point Believes DORM Is A “Strong Sell” 30% - 50% Downside For The Following Reasons:*

**Dorman Products (Nasdaq: DORM)** is an aftermarket auto parts distributor stuck between a rock and a hard place as it sells both through Amazon, which is seeking to grow further into online auto parts distribution, and through the biggest brick and mortar retailers (Adv. Auto Parts / O'Reilly / AutoZone), which account for a majority of its sales, and are struggling with slower growth and margin pressure. Spruce Point has conducted a deep fundamental and forensic accounting review of DORM and believe its opaque disclosures, aggressive accounting, and precarious industry positioning do not warrant its significant share price outperformance and premium valuation relative to peers. As a result, we see above average risk of continued earnings disappointment and meaningful share price correction

- **Revenue Growth Slowing and Overstated:** Revenue growth has slowed from a 13% CAGR (2009 to 2015) to less than 6% in 2016 (adjusted for extra week). Furthermore, if you look under the hood, DORM's net revenues are an estimate and therefore subject to significant manipulation. Our adjusted gross sales estimate (we define as total product places on the shelves of customers) slowed to an abysmal 1.5% in 2016. Analysts expect DORM to continue growing top-line sales at 7% which we believe to be difficult given its largest customers are growing low single digits
- **Product Innovation Slowing, Prices Deflating:** Unique products introduced declined 13% in 2016, the first contraction in years. Piecing together clues from DORM's various disclosures, we estimate average revenue from new part introductions has been in a multiyear decline, while its annual R&D spend increases. DORM has no patent protection for its products, making it easy for competitors to copy key parts. Furthermore, its own product copies are increasingly being challenged by recent undisclosed litigation (eg. General Motors)
- **Hidden Margin Benefits From Aggressive Capitalization and FX Tailwinds Coming To An End:** We believe DORM's earnings leverage is waning. Revenue and gross profit from active accounts slowed to low single digits in 2016. The weakening of the Chinese Yuan has been a hidden tailwind to gross margins in the last three years since DORM sources products heavily from China/Taiwan. We estimate that DORM's gross margins benefited by ~350bps cumulatively from 2014-2016. DORM doesn't discuss any of these FX benefits in its MD&A, and now the Yuan is on a strengthening cycle. DORM also embarked on an ERP implementation which was 163% over budget, and allowed it to capitalize \$38m of costs from 2011-14. DORM has not amortized any of these costs, thereby inflating its earnings per share by \$0.07c by our estimate
- **Balance Sheet Strain Becoming More Evident:** DORM portrays itself as debt-free, but is heavily dependent on factoring receivables, which we believe should be evaluated as debt. The % of revenues that are factored annually has risen from 21% in 2009 to 65% in 2016 and exposes DORM to the increasing interest rate env't. DORM's working capital to sales ratio is at a multi-year high, while operating cash flow in 2016 abnormally increased from inventory declining - suggesting it liquidated or deferred new purchases to generate cash. DORM is also shifting its business strategy to invest in many undisclosed JV/minority investments, while opaque related-party purchases are increasing
- **Valuation Premium Unwarranted, 30%-50% Downside Risk:** The Berman family, DORM's controlling shareholder, has been selling heavily in recent years along with DORM's top long-term fundamental owners, using company cash to repurchase shares. Just two analysts see 18% upside, while the market ascribes a premium multiple of 2.5x, 11x, and 20x 2017E Sales, EBITDA and EPS. We normalize DORM's financials for aggressive cost capitalization and adjust its enterprise value for minority investments and factored receivables as debt. If DORM traded in-line with its aftermarket auto part peers at 1.1x-1.5x 17E sales, 2x-3x book value, or 13x-15x 17E P/E we justify 30%- 50% downside risk potential



# DORM's Adjusted Valuation

DORM's valuation is rich and fails to correctly adjust its financials for its "hidden" debt through aggressive factoring policies, as well as for recent minority interest investments which DORM fails to give proper transparency for, and analysts fail to account for in their valuation.

\$ in millions, except per share figures

	Street	Spruce Pt.	Street Valuation	LTM 7/17	2017E	2018E
	<u>As Report</u>	<u>Adjusted<sup>(1)</sup></u>				
Stock Price	\$70.00	\$70.00	EV / Sales	2.5x	2.5x	2.3x
Diluted Shares Outstanding	34.3	34.3	EV / EBITDA	12.4x	11.1x	10.1x
<b>Market Capitalization</b>	<b>\$2,402.6</b>	<b>\$2,402.6</b>	Price / Street EPS	21.8x	20.3x	18.4x
<b>Total Debt Outstanding</b>	<b>\$0.0</b>	<b>\$373.3</b>	<b>Market Implied Growth</b>			
(-) Cash and Marketable Securities	\$129.2	\$129.2	Sales	--	7.8%	6.5%
(+) 33% Minority Interest (Jan 2017)	\$0.0	\$10.0	Street EPS	--	14.2%	10.0%
(+) 40% Powertrain Minority Interest (2016)	\$0.0	\$6.2	<b>Spruce Point Adjusted (2)</b>			
(+) Minority Interest (2015)	\$0.0	\$2.1	EV / Sales	3.0x	2.9x	2.7x
<b>Enterprise Value</b>	<b>\$2,273.4</b>	<b>\$2,665.0</b>	EV / EBITDA	13.4x	13.0x	11.8x
			Price / Adj. EPS	22.3x	21.5x	20.2x

Source: DORM Filings, Wall. St Estimates

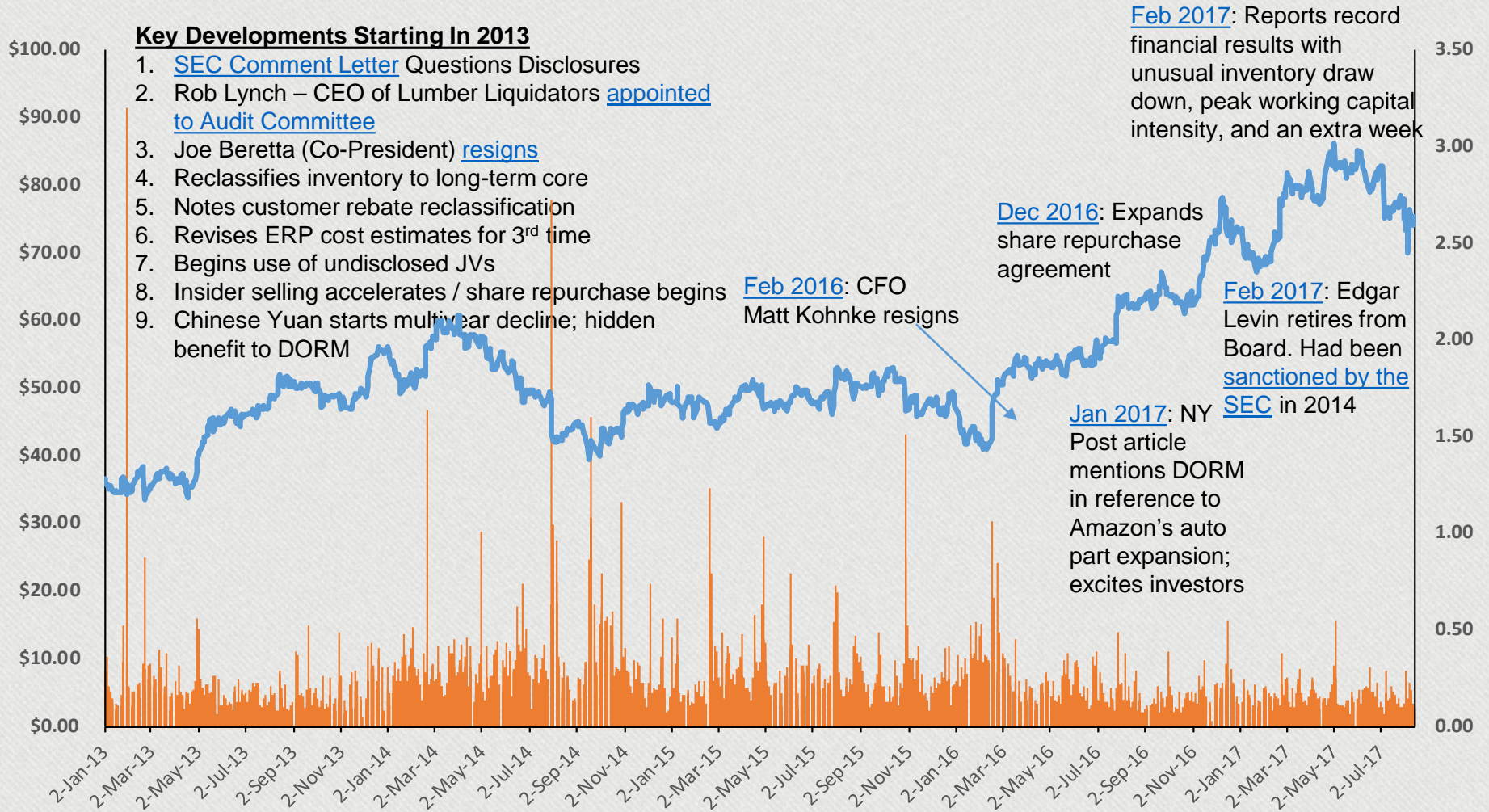
1) Pro forma adjusts the balance sheet to treat accounts securitization programs as debt and for recent minority investments

2) Includes amortization costs over 10yrs and assumes a 35% tax rate for DORM's aggressively capitalized ERP project



# DORM's Share Price Near All-Time Highs Merits Scrutiny

DORM's share price is near all time highs and it is reporting record results despite its largest customers (Advance Auto Parts, AutoZone, O'Reilly,) experiencing a rapid slow down and margin compression.







## *Evidence of Financial Struggles*



# *DORM's Suspicious Financial Activities Started When Macro Drivers Turned Negative*

The typical warranty period for a new car ranges from 3 to 5 years. Therefore, we estimate that DORM's sweet spot for aftermarket parts is mainly concentrated in vehicles that are 6-12 years old. Not surprisingly, we find that DORM's aggressive financial and accounting policies started post 2013 when its addressable market declined significantly. The next three years also do not bode well for DORM as evidence emerges that peak auto production is 2016.

## Addressable Cars Based On Historical SAAR

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017E	2018E	2019E
Auto SAAR	13.5	10.6	11.8	13.1	14.8	15.9	16.9	17.8	17.9	17.5	17.0	17.0
% growth	-18%	-21%	11%	11%	13%	7%	6%	5%	1%	-2%	-3%	0%
Cars In 6-12yr Age Cohort	118.3	120.1	121.5	121.2	119.9	115.9	109.4	104.2	100.0	97.4	96.2	96.6
% growth	1.3%	1.5%	1.2%	-0.2%	-1.1%	-3.3%	-5.6%	-4.8%	-4.0%	-2.6%	-1.2%	0.4%

Source: St. Louis Fed, Spruce Point estimates  
SAAR= Seasonally Adjusted Annual Rate

Coincided With Start of  
Insider Sales / Company  
Share Buyback, Aggressive  
ERP Capitalization,  
Restatements and Inventory  
Reclassifications

We project a fairly  
unfavorable outlook  
although not as bad as  
2013-16

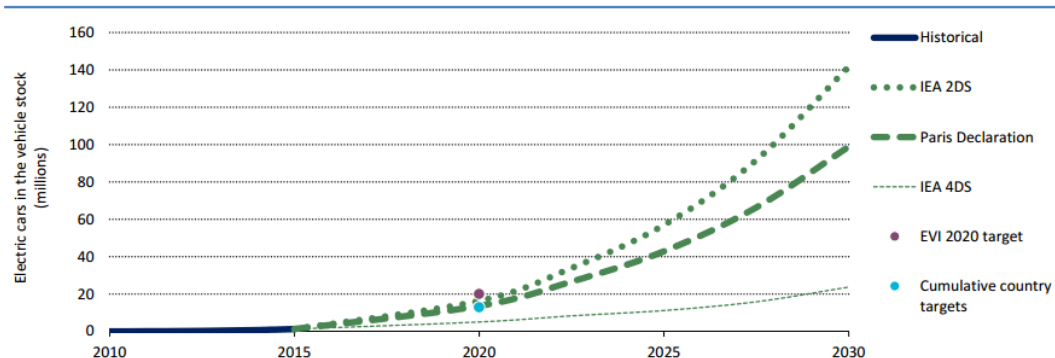


# Car Electrification A Longer-Term Negative For DORM

Predictions for the rate of electric vehicle growth vary widely. However, we can safely assume incremental unit growth and market share gains vs. traditional gas-powered vehicles is a negative for aftermarket auto part suppliers such as DORM. Electric vehicles have fewer part and require less maintenance according to government studies.

- The electric vehicle has one moving part, the motor, whereas the gasoline-powered vehicle has hundreds of moving parts. Fewer moving parts in the electric vehicle leads to another important difference:
  - The electric vehicle requires less periodic maintenance and is more reliable
- The gasoline-powered vehicle requires a wide range of maintenance, from frequent oil changes, filter replacements, periodic tune ups, and exhaust system repairs, to the less frequent component replacement, such as the water pump, fuel pump, alternator, etc
- The electric vehicle's maintenance requirements are fewer and therefore the maintenance costs are lower. The electric motor has one moving part, the shaft, which is very reliable and requires little or no maintenance ([source](#))

**Figure 3 • Deployment scenarios for the stock of electric cars to 2030**



Note: 2DS = 2°C Scenario; 4DS = 4°C Scenario.

Sources: IEA analysis based on IEA (2016), UNFCCC (2015b), the EVI 2020 target and the country targets assessment made in Table 3.

Source: [IEA Global EV Outlook 2016](#)



# *Bulls Giving Too Much Weight To DORM's Amazon Partnership To Bail It Out*

We believe DORM's share price has outperformed since investors have been optimistic about recent press stating that DORM has signed a deal with Amazon to distribute auto parts. (1)

Spruce Point has done its own independent channel checks, and believes that expectations should be tempered. We believe DORM risks significantly agitating its largest customers due to the inherent channel conflict of competing directly against its biggest customers.

- Although, it might be easy for Amazon to penetrate the Do-It-Yourself (DIY) business, where the customer can accept delivery over 1-3 days, the Do-It-For-Me (DIFM) channel is different. Typically, the DIFM portion of the aftermarket business will require a part in less than an hour (i.e. while the car is on the beam), which is not a time delivery capability that Amazon can currently accommodate. On the DIY side of the business, customers that we have spoken with believe that there are conversations that need to be had in the store, and price is not the only customer consideration
- During the course of our diligence, we reviewed commentary from some of DORM's largest customers who are monitoring the situation, and prepared to make competitive responses if DORM's market strategy significantly conflicts with their own:
  - Potential responses include: direct sourcing of product or striking larger deals with some of DORM's competitors
- DORM's top 4 customers represent 60% of their GAAP revenues and "concentration amongst customers" is a risk that we believe is largely being ignored. One customer we heard from specifically believed that DORM's escalating SKU proliferation on major omni-channel websites is degrading its brand. Furthermore, should Amazon begin to impede on the business of the Big 3, a competitive response should be expected
- Eventually the power of DORM's core customer base may not bode well for it. Also, given Amazon's increasing heft and power, what would stop it from further disintermediating the supply channel by going direct to source products from China and Taiwan?

1) Amazon's next frontier to conquer? Auto parts, [NY Post](#), Jan 22, 2017



# Customers Not Dependent On DORM

While DORM has significant dependency on its top 4 customers, the same can not be said about its customers dependency on DORM. DORM represents just 1.4% of sales of its top 4 customers.

\$ in mm	2010	2011	2012	2013	2014	2015	2016
General Parts (1)	\$5,608	\$6,061	\$6,321	\$7,489	\$8,097	\$8,015	\$8,112
O'Reilly	\$5,398	\$5,789	\$6,182	\$6,649	\$7,216	\$7,967	\$8,593
AutoZone (2)	\$7,565	\$8,206	\$8,671	\$9,250	\$9,642	\$10,313	\$10,717
Advanced Auto	\$5,925	\$6,170	\$6,205	\$6,494	\$9,844	\$9,737	\$9,568
<b>Total Sales of Top 4 DORM Customers</b>	<b>\$24,496</b>	<b>\$26,226</b>	<b>\$27,379</b>	<b>\$29,882</b>	<b>\$34,799</b>	<b>\$36,032</b>	<b>\$36,990</b>
DORM Sales Top 4%	\$438 55%	\$513 57%	\$570 57%	\$664 57%	\$751 60%	\$803 60%	\$860 60%
Sales To Top 4 DORM %	<b>\$241 1.0%</b>	<b>\$293 1.1%</b>	<b>\$325 1.2%</b>	<b>\$379 1.3%</b>	<b>\$451 1.3%</b>	<b>\$482 1.3%</b>	<b>\$516 1.4%</b>

- 1) Reflects automotive revenue segment – NAPA
- 2) AutoZone results are calendarized on November year end



# DORM's Largest Customers Are Already Struggling – Is DORM Immune?

DORM's largest customers are in the Do-It-Yourself (DIY) retail market with 60% of revenues going to its top 4 customers in this segment in 2016. DORM's bulls would like to believe that its growth profile is secular story. The total amount of product that DORM shipped to customers on an annual basis was below the industry in 2016

## YTD 2017 Negative Trends Have Persisted Among DORM's Customers:

- [Weak Sales at O'Reilly Send Shares Tumbling 20%](#) July 2017 - Pre-announced SSS growth of 1.7% for Q2, below 3-5% guidance
- [AutoZone Q3 SSS Decline by 0.80%](#) May 2017
- [Advanced Auto: You Knew It Was Coming](#) May 2017 SSS -2.7% vs. -1.2% consensus
- [Advanced Auto: What Just Happened?!?!?](#) Aug 2015 SSS to drop between 1% and 3% this year, below expectations for a 0.5% decline

## DORM's Growth Lags Its Biggest Customers

	2010	2011	2012	2013	2014	2015	2016
Advanced Auto	8.1%	2.2%	-0.8%	-1.5%	2.0%	1.3%	1.6%
AutoZone (1)	7.5%	5.0%	1.3%	1.4%	3.4%	3.6%	0.8%
O'Reilly	8.8%	4.6%	3.5%	4.3%	6.0%	7.5%	4.9%
<b>Simple Average</b>	<b>8.1%</b>	<b>3.9%</b>	<b>1.3%</b>	<b>1.4%</b>	<b>3.8%</b>	<b>4.1%</b>	<b>2.4%</b>
<u>DORM Sales Trend</u>							
<b>GAAP Growth</b>	<b>16.1%</b>	<b>17.2%</b>	<b>11.1%</b>	<b>16.5%</b>	<b>13.1%</b>	<b>6.9%</b>	<b>5.8%</b>
<b>Adj. Growth</b>	<b>18.3%</b>	<b>15.6%</b>	<b>11.7%</b>	<b>15.5%</b>	<b>15.8%</b>	<b>8.1%</b>	<b>1.5%</b>



1) Calanderized AutoZone's sales using a November fiscal yr end  
2) 2016 adjusted for 52 week year for comparison purposes



# Signs of Slowing Revenue Growth

DORM's reported revenue growth is "net" of certain adjustments such as customer credits. The Company applies heavy customer credits (disclosed only annually) and last year's results included an extra week too. The credit provisions are subject to significant estimation by management. We think investors should focus on gross sales. By pro forma adjusting results, we estimate an anemic 1.5% growth rate last year – hardly exciting.

**Revenue Recognition and Allowance for Customer Credits.** Revenue is recognized from product sales when goods are shipped, title and risk of loss have been transferred to the customer and collection is reasonably assured. We record estimates for cash discounts, product returns, promotional rebates, core returns and other discounts in the period of the sale ("Customer Credits"). The provision for Customer Credits is recorded as a reduction from gross sales and reserves for Customer Credits are shown as a reduction of accounts receivable. (Source: DORM 10-K, p.21)

## DORM's Adjusted Revenue Growth

\$ in mm	2011	2012	2013	2014	2015	2016	2016PF (1)
Weeks	53	52	52	52	52	53	52
Reported Sales	\$513.4	\$570.4	\$664.5	\$751.5	\$803.0	\$859.6	\$849.6
% growth	17.2%	11.1%	16.5%	13.1%	6.9%	7.1%	5.8%
GAAP Provision (2)	\$111.2	\$127.6	\$141.5	\$182.2	\$206.6	\$175.3	\$175.3
Adj. Revenues	\$624.6	\$698.0	\$806.0	\$933.7	\$1,009.5	\$1,034.9	\$1,024.9
% growth	15.6%	11.7%	15.5%	15.8%	8.1%	2.5%	1.5%

1) Adjusts 2016 for 52 week year for comparison purposes

2) The provision deducted from gross sales to arrive at GAAP revenues is reported annually at the end of the 10K (Schedule II: Valuation and Qualifying Accounts)



# Declining New Part Introductions and Price Deflation Weighing on DORM

DORM's financial reporting obscures its new product price deflation – you have to look carefully both at the press release and 10-K Annual Report. Upon close inspection, we find that unique part introductions declined in 2016, while its R&D spending is increasing, and average revenue from new products decreases.

## DORM's Reporting Obscures Its Price Deflation – Look Carefully At Press Releases and 10-K

\$ in mm expect avg part revenue	2012	2013	2014	2015	2016
New Parts To Aftermarket	800	873	1,266	1,495	1,255
Line Extension	~2,083	2,587	2,476	3,357	2,965
<b>Total Annual Unique Parts (1) % growth</b>	<b>2,883 --</b>	<b>3,460 20%</b>	<b>3,742 8.2%</b>	<b>4,852 29.7%</b>	<b>4,220 -13.0%</b>
Unique Parts in Last 24mos	--	6,343	7,202	8,594	9,072
Sales from New Products Past 24mos	--	\$146.2	\$165.3	\$152.6	\$146.1
% of Sales from New Products Past 24mos (2)	--	22.0%	22.0%	19.0%	17.0%
<b>Avg. Revenue From New Part Introduction</b>	--	<b>\$23,046</b>	<b>\$22,955</b>	<b>\$17,752</b>	<b>\$16,108</b>
Annual R&D Spend % of net sales	\$10.5 1.8%	\$13.4 2.0%	\$15.8 2.1%	\$16.8 2.1%	\$18.9 2.2%

Parts Price Deflation

With More R&D Spending

1) Disclosed 10-K Annual Report  
 2) Disclosed in year end press release



# Signs of Earnings Leverage Slowing...

DORM is stretched to increase its recent performance. While increasing its sales and gross profit per average active account significantly in the past 6 years, the growth rates in 2016 declined to its lowest level in years.

Note that DORM only discloses Active Accounts annually in its 10-K

## DORM's Sales and Gross Profit Per Active Account

\$ in mm	2011	2012	2013	2014	2015	2016
Sales % growth	\$513.4 17.2%	\$570.4 11.1%	\$664.5 16.5%	\$751.5 13.1%	\$803.0 6.9%	\$859.6 7.1%
Gross Margin % growth	\$189.3 12.1%	\$215.2 13.7%	\$261.0 21.3%	\$287.2 10.1%	\$308.1 7.3%	\$338.1 9.7%
Active Accounts % growth	2,800 --	2,800 --	3,100 10.7%	2,300 10.7%	2,300 10.7%	2,550 10.9%
Sales / Active Account % growth	\$183,369 8.8%	\$203,721 7.8%	\$225,241 10.6%	\$278,324 23.6%	\$349,112 25.4%	\$354,474 1.5%
Gross Profit/Active Account % growth	\$67,595 4.1%	\$76,860 13.7%	\$88,464 15.1%	\$106,371 20.2%	\$133,935 25.9%	\$139,412 4.1%

Source: DORM Financials

Growth Rates Below  
Sales and Gross Profit  
For First Time In Years



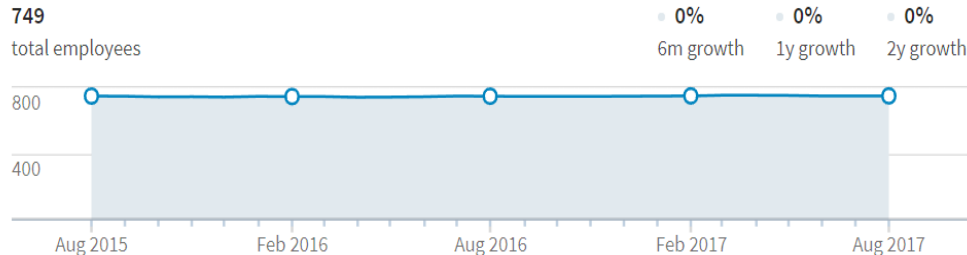
# DORM Employment Growth

Recent employment and hiring data from LinkedIn suggest a stagnation of employment growth in the last twenty four months – consistent with our view of moderation in business trends.

## Flat Employment Trends

### Total employee count ⓘ

Based on LinkedIn data. Excludes subsidiaries.



Source: LinkedIn

## Historical Employment Growth

Year	Total Employees	% Growth
2016	1,860	4.5%
2015	1,780	-0.3%
2014	1,785	22.9%
2013	1,452	9.9%

Source: DORM Annual Reports



# DORM Foreign Import From Suppliers Also Not Growing...

DORM's foreign importation of product from suppliers has generally not grown in the past ten years. Imports make up a substantial % of its product supply.

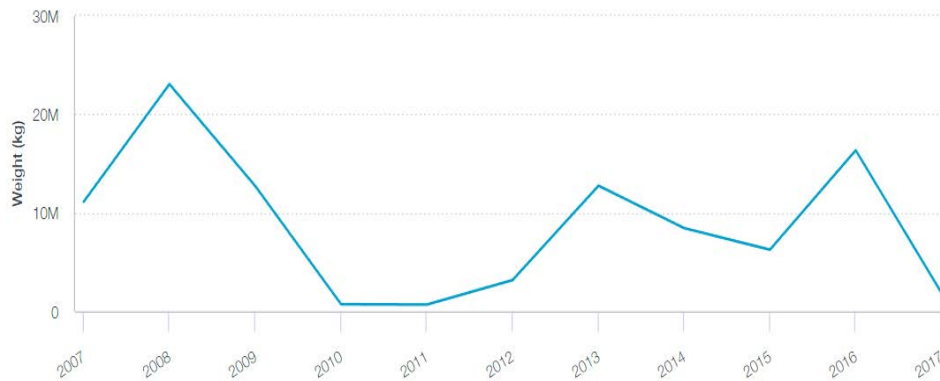
**DORM Shipments**



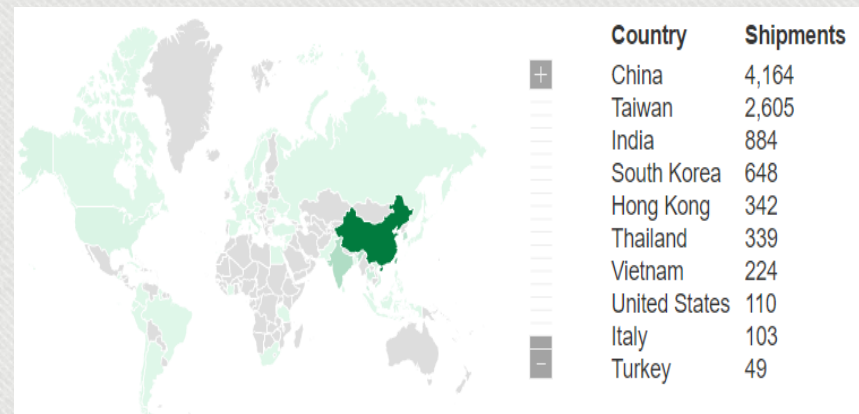
**Domestic vs. Foreign Supply Product Imports**

Year	US Suppliers	Foreign Suppliers
2016	23%	77%
2015	29%	71%
2014	27%	73%
2013	25%	75%
2012	20%	80%
2008	20%	80%

**DORM Shipments By Total Weight (Kg)**



**DORM Shipments By Country of Origin**





# DORM Lacks Patent Protections, Counterfeits and Litigation Risk Rising

In our view, DORM's business is fraught with business risk given that it has nothing proprietary and is not listed as the inventor for any patents (1). A portion of its business model appears to be copying other companies products, and protecting none of its own. The rise of counterfeit auto parts (90% estimated to come from China where DORM sources products(2)) and escalation of copyright infringement litigation risk from major OEMs such as GM are unappreciated risks to the DORM growth story.

## Counterfeit Auto Part Headlines

Date	Counterfeit Auto Part Headline
<a href="#">May 2016</a>	"FEDs warn of counterfeit auto parts, Fake car parts from China are flooding US markets"
<a href="#">May 2016</a>	"Thousands Of Counterfeit Toyota Parts Discovered At Manufacturing Facility In China"
<a href="#">Nov 2016</a>	"Feds bust Chinese knock-off parts booths at SEMA Show"

## Recent Undisclosed DORM Litigation (3)

Parties v. DORM	Date	Litigation Description
Koleszar vs Dorman	5/12/2017	Anticompetitive, unfair and fraudulent conduct
dlhBOWLES vs Dorman	4/28/2017	Patent Infringement on washer nozzles
GM vs Dorman	8/17/2015	Copyright Infringement
PACCAR vs Dorman	11/1/2013	Patent infringement, unfair competition, etc.



25. GM purchased in Michigan a sample of a module sold by Dorman, and confirmed that it has an unauthorized copy of GM's copyrighted software on it.

26. GM has notified Dorman that it is not authorized to sell pre-programmed GM modules.

27. GM has notified ERC that it is not authorized to manufacture pre-programmed GM modules.

**CAUSES OF ACTION**

**COUNT 1 – COPYRIGHT INFRINGEMENT**

28. GM repeats and re-alleges herein each of the foregoing paragraphs.

29. As alleged above, GM owns copyrighted software and other computer files, including a large number of vehicle calibration files, firmware, data compilations, and other computer files for its vehicle electronic control modules.

30. GM has registered its copyrights in this material.

31. On information and belief, Defendant ERC has infringed these copyrights by, among other things, selling vehicle control modules with infringing copies of GM's copyrighted software and other computer files loaded on them.

32. On information and belief, Defendant ERC obtained at least some blank modules from Dorman, programed them, and sold them to Dorman or to others.

(1) US Patent Office Search. DORM says "While we take steps to register our trademarks and copyrights when possible, we believe that our business is not heavily dependent on such trademark and copyright registration." 10K, p. 7 (2) Ruttencutter, Dept. Homeland Security, [Aug 2017](#) (3) DORM's 2015 10-K started listing claims of IP infringement from OEMs as a risk factor but has never mentioned the GM lawsuit or others specifically





## *Evidence of Hidden Leverage, Aggressive Accounting, and Poor Financial Disclosure*

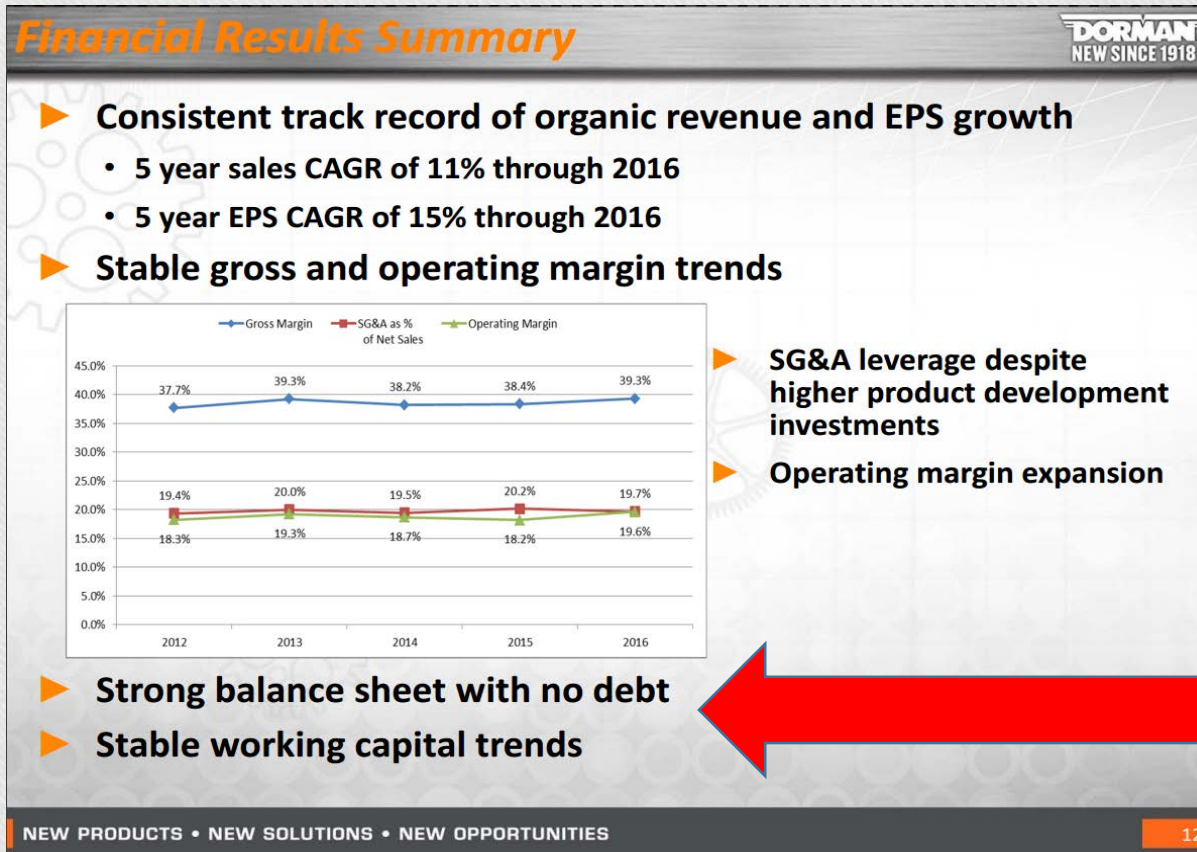


# Potentially Misleading Balance Sheet Claims To Investors

We previously called out CECO Environmental for its aggressive investor presentation materials which understated its true financial leverage. (1) The Company corrected its materials after our criticism.

We view DORM's presentation of its financial leverage as even more distorted.

It makes the bold claim that its balance sheet is strong with no debt and working capital trends are stable.



Source: DORM's May 2017 [Investor Presentation](#)

# DORM's Hidden Debt

DORM sells its accounts receivables through customer sponsored programs to financial institutions. In the absence of selling its receivables, DORM discloses the additional receivables that would have been outstanding. If it could not sell these receivables, it would certainly have to borrow on its credit facility or issue long-term debt to fund itself. Our research suggests that DORM's customers could delay paying those receivables up to a year. DORM runs the interest costs of these factoring programs through its income statement in the SG&A line – further evidence to us that DORM would like to obfuscate this form of debt. From an analytical perspective, we believe investors should adjust DORM's financials to consider its hidden debt.

\$ in mm	2009	2010	2011	2012	2013	2014	2015	2016	7/1/17
Accounts Receivables, Net on Balance Sheets	\$88.2	\$101.9	\$124.3	\$140.2	\$180.8	\$206.0	\$203.9	\$230.5	\$230.4
Accounts Receivables Assuming No Factoring	\$55.9	\$77.1	\$137.0	\$180.5	\$267.8	\$298.9	\$335.9	\$338.3	\$373.3
Less: Cash and Equivalents	\$10.6	\$30.5	\$50.2	\$27.7	\$60.6	\$47.7	\$78.7	\$149.1	\$129.1
<b>Adjusted Net Debt</b>	<b>\$45.3</b>	<b>\$46.6</b>	<b>\$86.8</b>	<b>\$152.8</b>	<b>\$207.2</b>	<b>\$251.2</b>	<b>\$257.2</b>	<b>\$189.2</b>	<b>\$244.2</b>
Annual Factoring	\$77.5	\$104.3	\$208.8	\$312.7	\$406.4	\$477.9	\$519.2	\$521.9	\$598.2 (1)
Factoring Cost (Included in SG&A) % imputed cost	\$2.0 2.6%	\$2.0 1.9%	\$3.5 1.7%	\$4.4 1.4%	\$5.2 1.3%	\$6.2 1.3%	\$7.2 1.4%	\$8.9 1.7%	\$10.1 1.8%

Source: DORM Financials  
1) Annualized based on mid-year sales

Note rising interest costs



# Working Capital Strain

Recall that DORM tells investors that its working capital trends are stable.

In our opinion, the strain on DORM's financial condition can be seen by its increasing working capital intensity. We evaluate DORM's working capital as a percentage of revenues and find that it has reached a cyclical high.

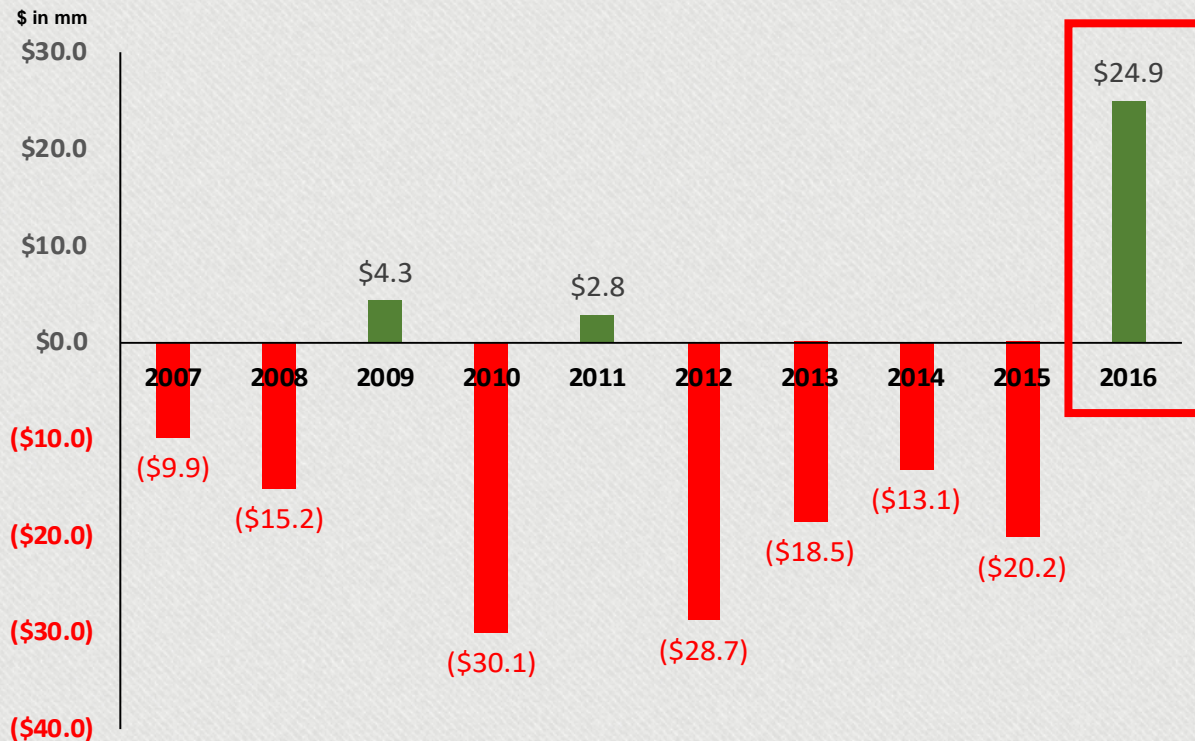


Source: DORM Financials

# Inventory Liquidation To Boost Cash?

Bolstering our suspicion of unsustainable cash flow, we observe that 2016 represented the largest contribution of inventory to operating cash flow in DORM's recent history. On the surface, it looks as if either DORM liquidated inventory and/or delayed replenishing new inventory to accelerate cash flow.

**Annual Changes of Inventory Contributing To Operating Cash Flow**



Source: DORM Annual Reports



# Aggressive Cost Capitalization: DORM's ERP Implementation Over Budget

During the period DORM's management was selling stock and the Company buying, DORM was selling investors on the benefits of its new Enterprise Resource Planning (ERP) system. The Company initially estimated it would cost just \$14.4m and revised estimates twice. The final cost came in at \$37.9m or 163% higher than initial estimates. Either DORM was completely sloppy in its financial estimates, or the Company intended to aggressively capitalize costs to inflate earnings and its share price.

DORM FY	DORM's Commentary on its ERP
<a href="#">2011</a>	In the third quarter of fiscal 2010, we began a project to replace our enterprise resource planning system. <b><u>This project is expected to cost approximately \$14.4 million in software, installation services and capitalized internal costs in 2010 through 2013.</u></b> Through December 31, 2011, we have spent \$6.6 million on the project, of which \$4.8 million was spent in fiscal 2011.
<a href="#">2012</a>	In the third quarter of fiscal 2010, we began a project to replace our enterprise resource planning ("ERP") system. <b><u>This project is expected to cost between \$21.5 million and \$24.5 million for capitalized software, installation services and internal costs through 2014.</u></b> Through December 29, 2012, we have spent \$15.4 million on the project, of which \$8.7 million was spent in fiscal 2012, \$4.8 was spent in fiscal 2011 and \$1.9 million was spent in fiscal 2010.
<a href="#">2013</a>	In the third quarter of fiscal 2010, we began a project to replace our enterprise resource planning ("ERP") system. <b><u>This project is expected to cost between \$36 million and \$39 million for capitalized software, installation services and internal costs through 2014.</u></b> Through December 28, 2013, we have paid \$22.7 million for the project, of which \$7.4 million was spent in fiscal 2013, \$8.7 million was spent in fiscal 2012 and \$4.8 was spent in fiscal 2011. The installation of the new ERP system was completed at one of our subsidiaries in January 2013 without any disruption to our operations.
<a href="#">2014</a>	Our new ERP system was installed in two phases, the last of which was completed on September 29, 2014. <b><u>Through December 27, 2014, we have capitalized \$37.9 million related to the project</u></b> of which \$15.2 million was spent in fiscal 2014, \$7.4 million was spent in fiscal 2013, and \$8.7 million was spent in fiscal 2012. The installation of the new ERP system was completed without significant disruption to our operations.

# Where Is DORM's Amortization Expenses Associated With The ERP?

We believe DORM should be amortizing expenses associated with its ERP implementation. There are ample examples of public companies amortizing these costs. As can be seen from DORM's results, its amortization expense has been declining subsequent to completing its ERP, not rising as would be expected. We estimate DORM has boosted its EPS by at least \$0.07c per annum by avoiding amortization of ERP expenses (1)

## Calculation of DORM's Amortization Expense

\$ in mm	2014	2015	2016
Depreciation, Amortization, Accretion Expenses (Reported: Cash Flow Statement)	\$12.65	\$16.18	\$18.91
Less: Depreciation Expense (Reported in Note 4 on PP&E)	(\$12.20)	(\$15.90)	(\$18.70)
Estimated Amortization Expense	\$0.46	\$0.29	\$0.21

Source: DORM Annual Report. Note: DORM doesn't disclose what accretion relates to but we assume it is minimal

## Examples of Companies Disclosing Amortization of ERP Costs

Company	Disclosure
Team Inc (NYSE: TISI)	At the end of 2013, we initiated the design and implementation of a new ERP system, which is expected to be substantially installed by the end of 2017. <b><u>Amortization of the enterprise resource planning ("ERP") system development costs will be computed by the straight-line method, commencing in the period when substantial testing is completed and the asset is ready for its intended use</u></b> (Source: <a href="#">10-K</a> , Note 5)
NetScout (Nas: NTCT)	Certain costs incurred in the procurement and development of a new Enterprise Resource Planning, or ERP, system were capitalized in accordance with Statement of Position, or SOP, No. 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use", or SOP 98-1. Preliminary project planning costs associated with the project were expensed as incurred, while software license, integration, testing and other direct costs associated with the application development phase were capitalized. As of March 31, 2008 and 2007, capitalized software costs for the ERP system totaling \$3.8 million and \$3.3 million, respectively, is included on the balance sheet within fixed assets. <b><u>Amortization of internal use software began on August 1, 2007 and is being recorded on a straight-line basis over five years.</u></b> Amortization of internal use software was \$512 for the year ended March 31, 2008. (Source: <a href="#">10-K</a> , F-16)
Uni-Select (TSE: UNS)	For internally-generated intangible assets, <b><u>the Corporation records the costs directly attributable to the acquisition and development of an enterprise resource planning software ("ERP") and the corresponding borrowing costs. In order to accurately reflect the pattern of consumption of the expected benefits, the Corporation amortizes its software and related costs on a straight-line basis over a 10-year period.</u></b> The amortization period begins when the asset is available for its intended use and ceases when the asset is classified as held for sale or is derecognized. ( <a href="#">Annual Report</a> , p. 60)

1) Assumes straight-line 10yr useful life consistent with the upper range of DORM's software and computer useful life disclosure (10K, p.28) and 35% tax rate



# How Transparent Is DORM's Disclosure About Its Gross Margins?

DORM Has Been Pressed Before By The SEC For More MD&A Disclosures About Revenue/Cost Drivers...

**SEC Question To DORM:** *"We note that your current discussion of changes in results of operations for the various periods presented in your financial statements includes a discussion of the factors responsible for the changes in the various categories of revenue and expenses but does not provide adequate quantification as to how each factor impacted your results of operations for the various periods presented. Where multiple factors impact a line item in your financial statements, please revise to quantify, where practical, how each factor impacted your reported results of operations for the periods presented."*

**DORM's Response:** *"Our MD&A discussion of changes in our results of operations in future filings shall include, where practical, a quantification of how each factor responsible for changes in the various categories of revenue and expenses impacts the reported results of operations for the periods presented."*

Source: [SEC Comment Letter](#): 1/8/13

Yet, As Can Be Seen They Still Selectively Disclose, And Are Not Discussing A Major Hidden Cost Benefit (Next Slide)

2012  
Pre-  
Comment  
Letter

Net sales increased 11% over the prior year to \$570.4 million from \$513.4 million last year. **Excluding the impact of an additional \$4.8 million in sales due to a fifty-third week in fiscal 2011**, revenues increased 12% over fiscal 2011 levels. Our revenue growth continues to be driven by overall strong demand for our products and higher new product sales.

Cost of goods sold, as a percentage of net sales decreased to 62.3% in fiscal 2012 from 63.1% in the same period last year. Lower transportation costs contributed approximately one-half of the difference. The remaining variance was primarily the result of a favorable sales mix towards higher margin products, and provisions for excess and obsolete inventory which were \$1.0 million lower in fiscal 2012 than in fiscal 2011.

No Quantitative Disclosure in 2016

2016  
Post-  
Comment  
Letter

Net sales increased 7% to \$859.6 million in fiscal 2016 from \$803.0 in fiscal 2015. Our revenue growth was driven by overall strong demand for our products **and an additional week of sales in fiscal 2016**.

Gross profit margin was 39.3% in fiscal 2016 compared to 38.4% in fiscal 2015. The increased gross profit margin was primarily due to a favorable sales mix towards higher margin products, leverage of costs across higher sales volume, and approximately \$2.0 million of lower inventory provisions which were partially offset by lower overall selling prices during fiscal 2016 compared to fiscal 2015.

# FX Rates: Substantial Hidden Tailwind

The weakening of the Chinese Yuan has been a hidden tailwind to gross margins in the last two years: As illustrated in the table below, we estimate that DORM's gross margins benefited by 3% in FY16. In DORM's MD&A, they do not quantify the gross margin benefit from the weakening Chinese Yuan. Therefore, investors are left with a potentially misleading view about underlying operational factors driving the reported 90bp gross margin expansion.

**DORM's Discussion on FX Without Quantifying The Effect:** "To the extent that the U.S. Dollar changes in value relative to foreign currencies in the future, the price of the product for new purchase orders may change in equivalent U.S. Dollars. The largest portion of our overseas purchases comes from China. The Chinese Yuan to U.S. Dollar exchange rate has fluctuated over the past several years. Any future changes in the value of the Chinese Yuan relative to the U.S. Dollar may result in a change in the cost of products that we purchase from China. (Source: 2016 [10-K](#), p. 20)

\$ in mm	2011	2012	2013	2014	2015	2016
Reported COGS	\$324.2	\$355.2	\$403.5	\$464.3	\$494.9	\$521.5
Gross Margin % margin	\$189.3 36.9%	\$215.2 37.7%	\$261.0 39.3%	\$287.2 38.2%	\$308.1 38.4%	\$338.1 39.3%
% of COGS made in China (1)	70%	70%	70%	73%	71%	77%
COGS Benefit (Loss)	(\$10.3)	(\$5.9)	(\$5.5)	(\$2.7)	+\$5.2	+\$26.1
Avg \$/CNY FX % change	6.73 -0.6%	6.57 -2.4%	6.45 -1.9%	6.39 -0.8%	6.49 1.5%	6.91 6.5%
Est. Gross Margin Impact \$/CNY (bps)	-2.0%	-1.0%	-0.8%	-0.4%	0.7%	3.0%



Source: DORM Annual Reports  
Note: [IRS Avg. FX rates](#) assumed

(1) DORM discloses % of purchases from foreign countries, we assume China being the dominant source, with Taiwan second. Directionally the Taiwan Dollar and Chinese Yuan track each others movements



# Careful Look At “Other Assets”

Be careful of shifting of assets – DORM moved inventories into Other Assets - now calls it “Long-Term Core Inventory” (1)

(in thousands, except share data)	December 27, 2014	December 28, 2013
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 47,656	\$ 60,593
Accounts receivable, less allowance for doubtful accounts and customer credits of \$79,179 and \$65,879 in 2014 and 2013, respectively	206,035	180,777
Inventories	173,523	160,387
Deferred income taxes	25,103	20,798
Prepays and other current assets	3,147	5,851
Total current assets	455,464	428,406
Property, plant and equipment, net	82,270	64,786
Goodwill and intangible assets, net	29,989	30,089
Other assets	12,645	5,888
Total	\$ 580,368	\$ 529,169

DORM 2014 [10-K](#)

(in thousands, except share data)	December 28, 2013	December 29, 2012
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 60,593	\$ 27,708
Accounts receivable, less allowance for doubtful accounts and customer credits of \$65,879 and \$56,512	180,777	140,180
Inventories	164,421	145,270
Deferred income taxes	20,798	20,559
Prepays and other current assets	5,851	2,332
Total current assets	432,440	336,049
Property, plant and equipment, net	64,786	48,758
Goodwill and intangible assets, net	30,089	26,553
Other assets	1,854	1,323
Total	\$ 529,169	\$ 412,683

DORM 2013 [10-K](#). (1) DORM says “long-term core inventory represents products used in remanufacturing processes, and consists of used cores purchased and held in our facilities, used cores that are in the process of being returned from our customers and end-users, and remanufactured cores held in finished goods inventory at our facilities” Spruce Point notes that even LKQ, which discloses significant core part holdings in inventory, does not classify any of these as long-term assets ([10-K](#), p. 70)

# Suspicious Minority Investments and Rising Related-Party Purchases

DORM's business is becoming more opaque. It has made numerous undisclosed Joint Venture and Minority Investments, while ramping up related-party purchases. Its Long-Term "Other Assets" account with cores has also been rising rapidly. We caution that DORM could be using this account to improve operating cash flow, or delay inventory impairment.

\$ in mm	2010	2011	2012	2013 (1)	2014	2015	2016	7/1/17
Long-Term Other Asset	\$0.7	\$1.1	\$1.3	\$5.9	\$12.6	\$18.7	\$29.5	\$42.0
Undisclosed JV	--	--	N/A	\$1.8	\$2.4	\$2.0	\$4.8	N/A
Undisclosed Minority Investment	--	--	--	--	--	\$2.1		N/A
Powertrain Minority Investment	--	--	--	--	--	--	\$6.2	N/A
Undisclosed Minority Investment	--	--	--	--	--	--	--	\$10.0
<b>Core Inventory YoY Growth</b>	--	--	--	\$4.0 --	\$10.2 155%	\$14.6 43%	\$18.5 27%	N/A N/A
<b>Related Party Purchases (2)</b>	--	\$1.7	\$5.4	\$5.6	\$9.3	\$9.9	\$16.5	N/A

Source: DORM Annual Reports.

(1) Restatement of long-term other assets in 2013

(2) From JVs and minority investments, excluding lease payments to Berman Family of \$1.6m



# “Equity Income” Earnings Absent From DORM’s Income Statement

DORM states it has equity method investments. Income from these equity investments (the earnings from the minority investments) are not being reported through its income statement – why? Proper accounting and best financial presentation practices dictates that DORM should have a line item on its income statement to break out the contributions. In the table below, we show other auto supply companies using proper disclosure

## DORM’s Income Statement Where’s Income From Affiliates or Equity Income?

	For the Year Ended		
	December 31, 2016	December 26, 2015	December 27, 2014
(in thousands, except per share data)			
Net sales	\$ 859,604	\$ 802,957	\$ 751,476
Cost of goods sold	521,530	494,907	464,275
Gross profit	338,074	308,050	287,201
Selling, general and administrative expenses	169,473	161,893	146,467
Income from operations	168,601	146,157	140,734
Interest expense, net	241	216	204
Income before income taxes	168,360	145,941	140,530
Provision for income taxes	62,311	53,612	50,543
Net income	<u>\$ 106,049</u>	<u>\$ 92,329</u>	<u>\$ 89,987</u>
Earnings per share:			
Basic	\$ 3.07	\$ 2.60	\$ 2.50
Diluted	\$ 3.07	\$ 2.60	\$ 2.49
Weighted average shares outstanding:			
Basic	34,516	35,466	36,052
Diluted	34,598	35,538	36,190

Source: DORM Annual Report

Company / Income Statement Line Item	2016 Income From Affiliates
<a href="#">Delphi Automotive</a> “Equity Income, net of tax”	\$35.0
<a href="#">Magna International</a> “equity income”	\$233.0
<a href="#">Lear Corporation</a> “Equity in net income of affiliates”	\$72.4
<a href="#">Autoliv, Inc.</a> “Income from equity method investments”	\$2.6
<a href="#">BorgWarner Inc.</a> “Equity in affiliates’ earnings, net of tax”	\$42.9
<a href="#">Visteon Corporation</a> “Equity in net income of non-consolidated affiliates”	\$2.0

# Suspect Reclassifications

If rebates to a customer were erroneously calculated it suggests that DORM's COGS were under reported or sales were over reported. In our view, this reclassification should have been run through the income statement where the reduction in A/R was offset by a reduction in shareholders equity. DORM chose to adjust as an accrued liability. This further demonstrates how Dorman can potentially manipulate its financials

## Balance Sheet Items

Period	2012	Reclass 2012	Difference
Gross A/R	196.7	196.7	
Allowances	62.9	56.5	
A/R, net	133.8	140.2	6.4
Other Accrued Liabilities	5.1	11.5	6.4

## Schedule II: Valuation and Qualifying Accounts

	2012	Reclass 2012	
<b>Allowance for doubtful accounts</b>			
Balance, beginning of the period	1.4	1.4	
Provision	0.3	0.3	
Charge-offs	(0.2)	(0.2)	
Discontinued Operations	(0.3)	(0.3)	
Balance, end of period	1.1	1.1	
<b>Allowance for Customer Credits</b>			
Balance, beginning of 2011	51.9	46.5	5.4
Provision	145.2	127.6	(17.6)
Charge-offs	(135.2)	(118.5)	16.7
Discontinued Operations	(0.2)	(0.2)	
Balance, end of 2012	61.8	55.4	6.4
<b>Total</b>	<b>62.9</b>	<b>56.5</b>	

Source: 2012 10K and 2013 10K

- Re-classification of an Additional Liability was "deemed immaterial" and DORM decided **not to restate historical financials**. In the 2013 10K, **DORM** found that they had underestimated "Customer Rebates". In order to "balance the B/S", the company increased their A/R. This was achieved by reducing the A/R reserve
- From DORM's 2013 [10K](#) – Reclassifications:

*"The previously reported Consolidated Financial Statements include an adjustment to present accrued customer rebates which may be settled in cash as an accrued liability. The effect of this reclassification adjustment was a \$6.4 million increase to accounts receivable and other accrued liabilities as of December 29, 2012. We believe the adjustment is inconsequential to any previous annual or interim Consolidated Financial Statements. Additionally, certain other amounts in the prior-years Consolidated Financial Statements have been reclassified to conform with current-year presentation."*



# Audit Fee Warning

We always warn investors to look carefully at the audit fees being paid.

In the case of DORM, we observe that its audit fees are abnormally low relative to peers.

When viewed in context of the accounting abnormalities we've observed, we caution investors to remember the phrase  
"you get what you pay for"

## Audit Fee Benchmark: Small Cap Auto Part Companies

\$ in mm	Dorman Products DORM	Motorcar Parts MPAA	Standard Motor SMP	U.S. Auto Parts PRTS
Auditor	KPMG	E&Y	KPMG	RSM
Audit Fee	\$0.74	\$1.62	\$1.51	\$0.53
LFY Revenues	\$859.6	\$421.2	\$1,058.4	\$303.6
Total Assets	\$711.7	\$436.1	\$768.7	\$82.1
<b>Audit Fee / Total Revenues</b>	<b>0.09%</b>	<b>0.39%</b>	<b>0.14%</b>	<b>0.17%</b>
<b>Audit Fee / Total Assets</b>	<b>0.16%</b>	<b>0.43%</b>	<b>0.27%</b>	<b>0.69%</b>

Source: Company Financials





## *Valuation and Price Target*

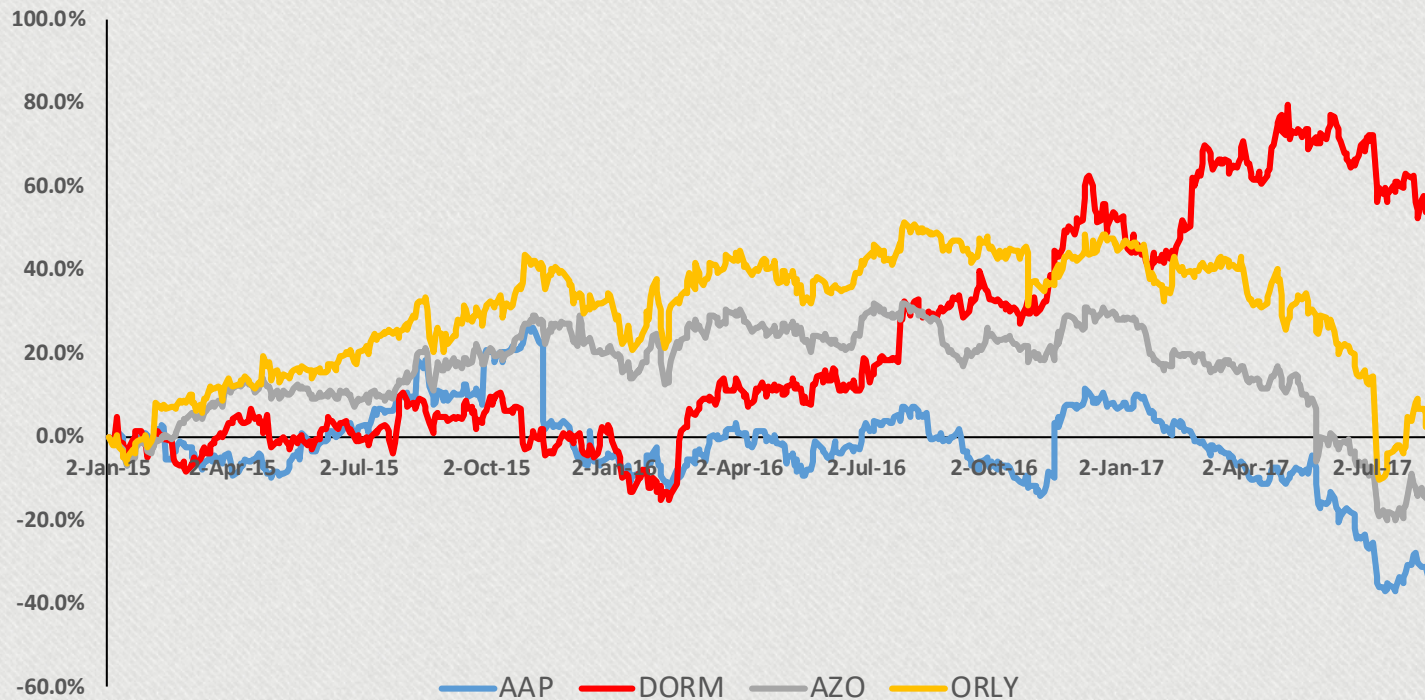


# Bull vs. Bear Debate on DORM

	Bull Case	Spruce Point Bear View
<b>Revenue Growth</b>	New to Aftermarket parts will continue to help DORM's growth profile and it will return to double digit growth.	New Part introduction is slowing. R&D is increasing. Electric vehicles and fewer parts per car a major headwind. Cars in DORM's sweet spot of 6-12yrs have limited growth outlook
<b>Gross Margins</b>	Highest gross margins in company history will persist	We estimate 3% gross margin benefit is largely do to weakened Yuan vs. USD. The Yuan is now strengthening
<b>Free Cash Flow</b>	Significant free cash flow growth \$37m (2013) to \$101m (2016)	FCF is coming from increased factoring, unsustainable gross margin tailwinds, inventory liquidation and reduced Capex
<b>Capital Structure and Capital Allocation</b>	No debt and significant financial flexibility; Returning Value Through Share Repurchases	Company's AR programs are debt. Interest expense disguised in SG&A. ERP financial planning was a disaster. Insiders selling while Company is buying
<b>HD Solutions</b>	Natural extension of aftermarket parts	Still less then a \$20M business after being introduced over four years ago. DORM notes that HD Solution was approaching 2% of company sales in 2Q16.
<b>Acquisition Strategy</b>	Acquisition strategy is aiding growth in adjacent markets in hybrid batteries (Re-Involt), chassis and suspension (Ingalls), drive shafts and driveline products (PTI)	We can't find any evidence that these acquisitions have aided in revenues or net income. In our view, DORM may be avoiding transparent reporting of equity + JV investments either due to poor performance or obfuscation of related-party dealing
<b>Legal</b>	No material litigation risk	Multiple ongoing patent lawsuits with GM and other big players
<b>Accounting</b>	Take management's word everything is fine	Numerous reclassifications and signs of aggressive accounting, most notably no amortization of ERP costs
<b>Amazon</b>	Amazon disintermediating the supply channel and cutting out the BIG 4 will allow for more margin to be shared between Amazon and DORM	Should Amazon be successful, a response from the Big 4 is likely which currently represents 60% of DORM's customer base

## *Warning: DORM Should Not Be Outperforming Its Customers/Sector*

DORM's stock price has outpaced its top customers for no good reason. While "The Big Three" struggle with poor recent performance and slowing SSS comps, DORM's share price is making all-time highs. We believe part of the increase is on false hope that DORM is a play on Amazon's move into the sector.





# *Terrible Risk/Reward Owning DORM: Analysts See 16% Upside In DORM*

DORM is underfollowed by the sell-side community aside from certain regional brokers. Surprisingly, the majority are “Neutral” on the stock and have recently downgraded the shares. We expect a substantial re-rating lower in the share price once investors critically analyze its financials.

Analyst	Recent Action	Recommendation	Price Target
Jefferies		Neutral	\$85.00
FBR & Co.	<b>Downgrade</b> / Feb 2017	Neutral	\$80.00
Barrington Research Associates, Inc.		Neutral	N/A
CL King & Associates, Inc.	<b>Downgrade</b> / Jan 2017	Neutral	N/A
Average Price Target % Implied Upside (1)			\$82.50 16.0%

1) Upside based on \$70 share price

# Index Funds and ETFs Driving DORM's Share Price, Not Fundamental Institutions

Spruce Point is concerned that long-time fundamental owners such as Royce, T. Rowe Price, and Dimensional Advisors have all been significant sellers of stock, while the majority of share accumulation has come from index/ETF driven investors such as Blackrock, Vanguard and State Street

Asset Manager	Share Ownership / % of Total	Recent Change In Shares / % Chg.	General Ownership Trend Past 2yrs	Orientation
Vanguard	2.8M / 8%	+127,653 / 4.7%	↑	Index/Quant/ETF
Blackrock	2.4M / 7%	+5,949 / 0.2%	↑	Index/Quant/ETF
Congress Asset Mgmt.	1.0M / 3%	+73,884 / 7.9%	↑	Fundamental
Royce & Assoc.	0.9M / 2.6%	-126,980 / -12.0%	↓	Long-Term Fundamental; once owned 15% in 2012 ( <a href="#">proxy</a> )
T. Rowe Price	0.8M / 2.5%	-35,930 / -4.0%	↓	Long-Term Fundamental; once owned 7% in 2011 ( <a href="#">proxy</a> )
Dimensional	0.8M / 2.4%	717 / --	↓	Quant / Small Cap; once owned almost 7% in 2012 ( <a href="#">proxy</a> )
Riverbridge	0.8M / 2.3%	-28,589 / -3.5%	↔	Fundamental SMID cap growth investor
NewSouth Capital	0.7M / 2.0%	-11,244 / -1.5%	↓	Fundamental SMID cap value investor
State Street	0.7M / 1.9%	51,982 / 8.7%	↑	ETF driven
Atlanta Capital	0.5M / 1.5%	-51,297 / -8.7%	↓	SMID cap growth

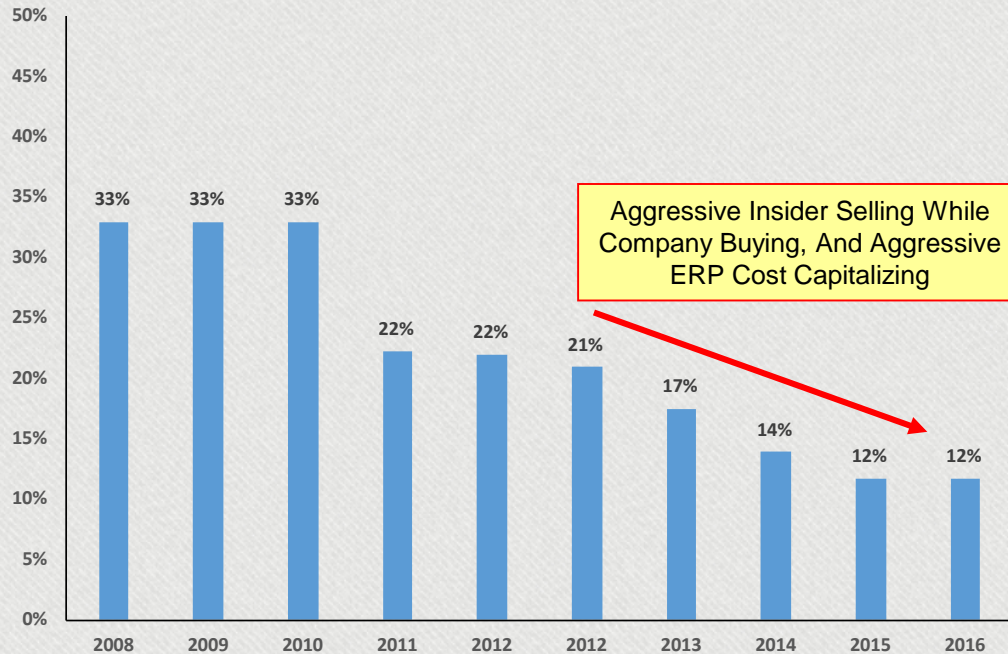
Source: Fund holding information and Morningstar



# Insiders Selling, Company Buying

**DORM has mostly been a family controlled business by the Bermans.**  
The family has been reducing its position in the Company alongside long-time shareholders, at the same time  
the Company is buying back stock  
This is generally a red flag we think investors should carefully consider

## Top Insider Beneficial Ownership



Source: DORM Proxy Statements

## Share Repurchase Programs

Date	Repurchase
<a href="#">12/12/13</a>	\$10m repurchase program
Various program increases	
<a href="#">12/9/16</a>	Additional \$100 million, raising the aggregate authorization under the program to \$250 million
<b>Total Value of Shares Repurchased 2011-YTD 2017</b>	<b>\$147.5m</b>

# DORM Trading At An Unjustified Premium To Its Peers

DORM trades at an irrational premium to both its customers and aftermarket auto part manufacturers and distributors.

DORM's top customers are expected to grow sales by ~3% yet analysts believe DORM can grow closer to 8%.

We believe this optimism should be tempered, especially in light of our illustration that DORM's adjusted sales growth has been underperforming its customers in the past two years. At best, we give DORM the benefit of the doubt that it can match industry growth

\$ in millions except per share figures

\$ in millions except per share figures													
Name	Ticker	Ent. Value	Stock Price 8/15/2017	% of 52-wk High	Growth Rates		P/E		Enterprise Value /				Price/ Book Value
					Sales '16 - '17E	EPS '16 - '17E			EBITDA		Sales		
							2017E	2018E	2017E	2018E	2017E	2018E	
After Market Auto Part Stores													
O'Reilly Automotive, Inc.	ORLY	\$20,038	\$196.00	68%	5.0%	9.6%	16.7x	15.0x	10.1x	9.5x	2.2x	2.1x	12.6x
AutoZone, Inc.	AZO	\$19,725	\$516.20	63%	2.0%	10.0%	11.7x	10.9x	8.2x	7.9x	1.8x	1.8x	NM
Genuine Parts Company	GPC	\$29,841	\$196.00	68%	3.9%	5.4%	41.3x	38.1x	22.9x	21.9x	1.9x	1.8x	9.0x
Advance Auto Parts, Inc.	AAP	\$7,224	\$87.10	49%	0.5%	-21.8%	16.3x	15.3x	6.8x	6.0x	0.8x	0.7x	2.1x
				Max	5.0%	10.0%	41.3x	38.1x	22.9x	21.9x	2.2x	2.1x	12.6x
				Average	2.8%	0.8%	21.5x	19.8x	12.0x	11.3x	1.7x	1.6x	7.9x
				Min	0.5%	-21.8%	11.7x	10.9x	6.8x	6.0x	0.8x	0.7x	2.1x
After Market Auto Parts Distribution													
LKQ Corporation	LKQ	\$13,210	\$33.70	93%	3.9%	24.7%	18.0x	16.0x	11.9x	10.9x	1.4x	1.3x	2.9x
Standard Motor Products, Inc.	SMP	\$1,078	\$44.50	80%	6.8%	2.8%	15.5x	12.9x	9.1x	7.2x	1.0x	0.9x	2.2x
Motorcar Parts of America, Inc.	MPAA	\$516	\$25.15	80%	12.8%	NM	10.8x	9.9x	5.7x	5.1x	1.2x	1.1x	1.9x
				Max	12.8%	24.7%	18.0x	16.0x	11.9x	10.9x	1.4x	1.3x	2.9x
				Average	7.8%	13.7%	14.8x	12.9x	8.9x	7.7x	1.2x	1.1x	2.3x
				Min	3.9%	2.8%	10.8x	9.9x	5.7x	5.1x	1.0x	0.9x	1.9x
Dorman Products, Inc.	DORM	\$2,273	\$70.00	79%	8.4%	10.0%	20.3x	18.4x	11.1x	10.1x	2.5x	2.3x	3.8x
Sprue Point Adjusted	DORM	\$2,665	\$70.00	79%	4.6%	6.5%	21.5x	20.2x	13.0x	11.8x	3.0x	2.9x	3.8x

Source: Wall St estimates. We adjust DORM's valuation for its minority interests and aggressive ERP capitalization



# *Spruce Point Estimates 30% – 50% Downside*

It's easy to see meaningful downside in DORM's price using a variety of valuation methods. DORM's current multiple is unjustified given its lack of transparency, fragile industry position, and signs of reduced earnings leverage.

\$ in millions, except per share amounts

Valuation	Low Price	High Price	Note
<b>Revenue Multiple</b> <u>2017E Sales</u> <b>Enterprise Value</b> <b>Plus: Cash</b> <b>Less: A/R Debt</b> <b>Less: Minority Investments</b> <u>Dil. Shares</u> <b>Price Tgt.</b> <b>% Downside</b>	1.1x <u>\$877</u> \$964 \$129 (\$373) (\$18) <u>34.3</u> \$20.50/sh -70%	1.5x <u>\$894</u> \$1,341 \$129 (\$373) (\$18) <u>34.3</u> \$31.40/sh -55%	We estimate a sales growth range of 2%-4% which is +/-1% around its largest clients' growth rate. We also adjust DORM's enterprise value for its accounts receivable debt and minority investments. DORM trades at a nonsensical 3x sales multiple with peers in the range of 1-1.5x
<b>P/E Multiple</b> <b>Spruce Pt. Adj 2017E EPS</b> <u>Price Target</u> <b>% Downside</b>	13.0x <u>\$3.20</u> \$41.60 -41%	15.0x <u>\$3.30</u> \$49.50 -29%	Our 2017E EPS includes the tax-effected amortization associated with DORM aggressive ERP capitalization
<b>Price / Book Value</b> <b>DORM Stated Book Value</b> <u>Price Target</u> <b>% Downside</b>	2.0x <u>\$18.33</u> \$36.67/sh -48%	3.0x <u>\$18.33</u> \$55.00/sh -21%	At 4x book value, DORM is significantly overvalued relative to peers. DORM should trade at a discount as a result of its financial statements and management team being less transparent (eg. DORM doesn't hold conference calls)

Downside based on \$70/sh price