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MORNING NOTE

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**PROLIANCE INTERNATIONAL INC.**
**(AMEX: PLI: $0.24, BUY)**
**INDUSTRY: TRANSPORTATION**

**Disclosures: 1, 10**

| FY: Dec | 2007E | 2008E | 2009E |
|---|---|---|---|
| EPS | ($1.18) | ($0.13) | $0.28 |

## PLI Poised To Grow As Soon As Senior Financing Secured

With trends now favorable to the automotive aftermarket, we recommend PLI as a BUY and an intriguing deep value play as soon as its senior secured credit facility is in place, which we expect late this year or early in 2009. PLI's ongoing cost reduction efforts are showing a solid improvement to operating margin. As the Chinese economy weakens, Chinese competition is weakening. Even better, a driver of sales growth has appeared in the international heavy-duty marine segment. We believe **that the operational turnaround is well underway and will be more visible in the market once new financing is in place.**

### Refinancing In Talks

PLI announced November 18 that it has signed a proposal letter with "a major bank" that would provide a new $60 million senior secured credit facility. PLI intends to complete a transaction by early 2009. This should allow PLI to replace its current lender, as it has been seeking to do for some months. We will **watch for this announcement**.

As previously reported, PLI has also signed a letter of intent with a group of institutional lenders to provide $30 million of mezzanine financing, subject to due diligence and PLI obtaining a new senior secured credit facility. After conversations with management, we are very encouraged that **PLI has been able to make progress toward this financing and amend its existing credit agreement in the current credit environment**.

### Favorable Trends In Counter-Cyclical Aftermarket

Unlike the U.S. OEM automakers, PLI has several trends working in its favor.

- Aftermarket demand is a function of the age of the vehicle fleet and miles driven. Although the latter are down year-to-date from last year, **now that gasoline prices have plunged back to earth and are at three-year lows, miles driven should rise.**

- **The average age of vehicles on the road is increasing as credit tightens and new car sales slow.** About 27 million vehicles on the road today are between eight and 11 years old, and 59 million more will age into that group in the next three years.

- **Increased price sensitivity** is driving consumers to service centers, which use aftermarket parts, over the more expensive dealerships. **Dealer consolidation** also has placed many customers outside the footprint of convenience and driven them to local repair shops.

Older cars, of course, need more maintenance. Most aftermarket sales are needed to keep the car functioning; PLI customer O'Reilly Automotive, for instance, estimates that 80% of its sales are "clearly not discretionary."

Others in the aftermarket agree that the outlook is good. For instance, Motorcar Parts of America, a maker of starters and alternators, in the September 30 quarter, boasted a rise in gross margin to 32.7% compared to 24.4% a year earlier, and operating income of $5 million, compared to $2.4 million in the prior year's quarter.

- MPAA has commitments for new customer business that management expects will annualize to $30 million. Management sees existing customers ordering parts steadily and even expecting increases.
- Monroe Muffler Brake also saw a strong quarter, with comparable store sales up 4.5%.
- All this supports our thesis that PLI should have the winds at its back now.

**More Production Shifted To Nuevo Laredo Instead Of Purchased In Asia**

PLI has slimmed down from over 1,900 employees in July 2005 to about 1,000 today. Of the 85 branches operating as recently as July 2005, only 35 remain open today.

- Gross and operating margins have substantially improved over the past year. PLI now has the capability, and thus the option, to produce about 75% of its own components, up from about 50%.
- Heavy-duty marine sales, an increasingly attractive part of PLI's story, continue to improve year-over-year.
- **PLI has reaffirmed its guidance to operating income of $20 million for the year,** excluding costs associated with the Southaven tornadoes and the associated amendments to the credit facility.

We maintain our price target of $3.00, which represents 11 times 2009 earnings. We maintain our BUY rating.

## DISCLOSURES

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This report has been written in accordance with current SEC regulations and the Standards of Practice developed by the Association of Investment Management & Research (AIMR). Our research has been conducted by employing analytical practices generally accepted as standard within the analytical industry. In this instance, a comparison of financial strength, a bottom-up earnings projection based on a recovery in the U.S. economy, and relative multiples, were employed. The target price was calculated on comparative EPS, sales and book value multiples, a projection of potential multiples given other similar operations, and our knowledge of small-cap markets when enjoying both a sector and a cyclical rebound. Our conclusions are, by the very nature of forecasting, speculative, but are also reasonable, supportable and consistent.
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**Accumulate** Purchase of the stock is recommended for above average appreciation over the next 12 to 18 months, but the buyer may have an opportunity to acquire the stock within a 10% trading range.

**Hold** Holding the stock is recommended because the share price has moved above the specific "Buy" range and, therefore, appreciation potential is less than or equal to the market.

**Sell** The stock has reached the target price objective and/or conditions have changed sufficiently to alter the outlook for the stock.

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