Economic conditions have bottomed out and are now recovering

Profits are down for public and almost all private dealers

Buy-sells are down 34% in Q1 2020

While blue sky values remain steady at some types of dealerships, values have fallen an estimated 10% at typical stores

Public equity valuations have rebounded, but are still down 14% since 2019

Buy-sells are resuming in June and will likely increase steadily for the balance of 2020

SEE PAGES 7 AND 16 FOR OUR OUTLOOK ON THE INDUSTRY AND BUY-SELLS
OVERVIEW

The first quarter created whiplash for the auto retail industry. Many dealers had strong profits in January and February and then had to shut down in March. Analysts now predict that dealers will sell 13.5M new units in 2020, down 21% from 2019. Economists debate whether we will see a V-shaped recovery, a U-shaped recovery or a more variable W-shaped recovery.

Fortunately, the recovery, in whatever shape it will be, has already begun. Sales jumped in May and some dealers are even telling us they generated all-time record high profits last month, a stunning turnaround from April when profits for most dealers were abysmal. Dealers are showing us that the auto retail business model is a highly durable one.

The decline in business due to the shutdown has given dealers time to re-evaluate their businesses and restructure their operations. Many have adopted digital retailing in order to sell and service vehicles while their showrooms have been shuttered. They are discovering they can sell vehicles profitably with less compensation expense. Some dealers have learned they can operate with relatively few people and don’t plan on restaffing to previous levels even when their businesses return to normal. And some dealers have become more focused on used sales and fixed operations to help balance out their sources of profits. All of these dealers are likely to emerge stronger from the pandemic.

It has been said that dealers are an eternally optimistic bunch. Perhaps their business model has trained them that optimism is a virtue in their business, that they can overcome almost any obstacle with creativity, hard work and listening to their customers. We are seeing this optimism percolate into the buy-sell market again. Despite the pandemic, our firm is on track to sell more dealerships in 2020 than at any time in our history. The buyers of these stores are investing hundreds of millions of dollars since they believe there is a bright future to auto retail.

360+ DEALERSHIPS
Bought or Sold Since 1996

$5.2 BILLION IN VALUE
360+ DEALERSHIPS
23 YEARS OF EXPERIENCE
#1 TRUSTED PARTNER

THANK YOU!

The team at Haig Partners would like to thank our clients, buyers, industry partners and associates as we celebrate these milestones.
The number of dealerships purchased by public and private dealers fell 34% in Q1 2020 compared to Q1 2019. In March, buyers became increasingly concerned about the potential decline in earnings caused by the pandemic. The economy began to shut down, and it became almost impossible to assemble the people and capital needed to close a transaction. Transactions that had been in the works for many months, even years, were scrapped or postponed.

The slowdown is a reversal from the momentum we saw in the buy-sell market after dealers enjoyed strong profits in 2019. Many groups were seeking to grow. Buyers felt confident about the future of auto retail and we were expecting an active buy-sell market that would lead to over 300 dealerships trading hands. In Q4 2019, by way of example, buyers acquired 44% more rooftops than they did in Q4 2018.

When we examined the transactions that did close in Q1 2020, we saw evidence of growing confidence from buyers. Group transactions accounted for 56% of the dealerships sold, an increase from the 50% of stores in group transactions that sold in Q1 2019. Since group transactions are typically more expensive than single point transactions, the average value per transaction was likely higher in Q1 2020 than a year ago. Single point transactions made up 44% of the stores sold in Q1 2020 down from 50% in Q1 2019.

As for segment mix, Q1 2020 saw a higher mix of domestic (54% vs 46%) stores changing hands while midline imports represented a smaller share (29% vs 35%). Luxury brand sales were 16% compared to 17%.

### U.S. DEALERSHIPS BOUGHT/SOLD

- **Berkshire Hathaway**
- **Public Acquisitions**
- **Private Acquisitions**

*Source: The Banks Report and Haig Partners*
OVERVIEW

Public Company Acquisition Spending Was Increasing Before Coronavirus

During the first half of 2019, the publics bought very few dealerships as their stock prices had been low due to investor concerns about tariffs, trade wars, rising interest rates, a declining SAAR, and fears caused by some of the tech disruptors. As acquisitions became more accretive, the public companies became more active in the buy-sell market, spending 8% more in Q1 2020 ($136M) than they did in Q1 2019 ($126M). What is lost in this data is the number of transactions that were not completed in Q1 due to the pandemic. Asbury’s termination of its much publicized $1B acquisition of a group in Texas is the best known corona casualty in the buy-sell market. That single deal would have represented more than twice the amount all of the publics combined spent in 2019 on dealerships.

It will take some time for the buy-sell market to recover. Deal activity largely died from the second half of March to mid-June. The Great Recession of 2008–2009 was the last time we saw a similar shock to the buy-sell market. Almost no deals were done during those years as buyers were focused on their own financial health and no sellers wanted to go to market when profits were down so much. But the Great Recession was caused by a major economic shock due to an asset bubble (real estate) bursting and a banking crisis that dramatically reduced capital availability. Many companies went bankrupt, including GM and Chrysler, as financing dried up and consumers withdrew.

Today’s environment is much different. While almost all firms in automotive are suffering, there is more optimism about the future and we are already seeing signs of life in the buy-sell market. Deals that did not die in Q1 are being scheduled for closing in June and July. Deals that were put together during the pandemic are moving forward to closing in Q3. It’s difficult to predict how many stores will trade in 2020, but most likely the number will be well below the levels we saw in 2019. Please see the “Buy-Sell Trends” section on page 20 for more information.

Dealership Values Are Down

We carefully track the buy-sell market to assess how buyers value various auto franchises. We analyze offers to the transactions that we are involved in and regularly speak with leading buyers and many attorneys and CPAs who are involved in acquisitions. The coronavirus has had a major impact on dealership performance so far in 2020, but most buyers are expecting some kind of recovery. This poses a challenge for dealership valuations. Buyers know they can’t base their offers solely on performance in 2020 because those values will likely be well below sellers’ expectations and no deals will occur. But given the loss of performance, most buyers are expecting to pay less for a dealership today than they would have paid before the pandemic hit.
A common dealership valuation method is based on the buyer paying for the tangible assets plus an amount for the intangible assets, also known as goodwill, or blue sky. Buyers using this method will pay a multiple (blue sky multiple) of historical adjusted pre-tax profits for blue sky. The historical adjusted pre-tax profit figure most often used is based upon the immediately preceding twelve month period. This method is problematic today as both buyers and sellers see 2020 results being highly distorted from the effects of COVID-19. With a number of important exceptions, most buyers believe performance in the next year or so is going to be below the performance of 2019, so they are looking for a discount to the value they would have paid in 2019. Sellers, however, can usually wait for a recovery, so unless the discount is relatively modest, they will not be willing to accept lower prices. The balancing point between buyer and seller expectations is becoming clearer to us thanks to the transactions we have successfully structured in this market that involve more than 25 dealerships.

There are two ways that we see buyers formulating their offers today. Either method is resulting in an estimated 10% decline in blue sky values for “average” dealerships compared to their values at the end of 2019.

- **Historical Results:** Many buyers are basing their offers on 2019 (pre-COVID) adjusted pre-tax profits instead of the most recent twelve-month period. They assume that future profits are going to be slightly lower. To compensate for lower profits, they are using slightly lower blue sky multiples to get the same return on investment.

- **Projected Results:** Other buyers are estimating what they believe the store might make in the twelve months after closing and basing their offer on these projected earnings. This means that weak months like March and April will be excluded from their calculation of blue sky. Our new favorite accounting term, EBITDAC, or “Earnings Before Interest, Taxes, Depreciation, Amortization and Coronavirus,” may be heard regularly in conversations between sellers and buyers who are using this method. These buyers are using blue sky multiples that were largely in effect at the end of 2019, so the same multiples, but on lower pre-tax profits.
For buyers who are using the Historical Results method described above, the table below provides our estimate of what multiple a motivated buyer participating in a competitive sales process (i.e., not the only buyer at the table) would be willing to pay for the goodwill of a franchise in a competitive process, in addition to the other dealership assets. The multiples for all franchises have been reduced by 0.5x at both the top and the bottom of the range. For the franchises on the right side of the graph, we estimate that buyers are typically paying an amount that is not based upon a multiple of earnings. The top of the range for these franchises has come down by an estimated $250K. Of course, actual multiples or prices paid by buyers for dealerships will vary depending upon a number of factors and could be higher or lower than the ranges we indicate. This is particularly true during this period where coronavirus is impacting some areas more than others. Cities like Las Vegas that are based on tourism, travel and gaming have suffered far greater job losses than cities like Austin or Salt Lake City that have higher educated workforces and have maintained much of their employment. Dealerships in these areas aren’t suffering much decline in performance so blue sky values there may be less impacted.

The table below provides a list of some qualifying factors that could impact the value paid for dealership.

### FACTORS IMPACTING MULTIPLES

<table>
<thead>
<tr>
<th>Increases Multiple</th>
<th>Decreases Multiple</th>
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<tbody>
<tr>
<td>• Underperforming Financially</td>
<td>• Dealerships Not Marketed Properly</td>
</tr>
<tr>
<td>• Metro Markets Where There Are More Buyers</td>
<td>• Facility Issues/Upgrades Required</td>
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<tr>
<td>• Rapidly Growing Markets</td>
<td>• Rural Areas</td>
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<td>• Low Tax Markets</td>
<td>• Located in Slow/Negative Growth Markets</td>
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<td>• Low Real Estate Costs</td>
<td>• Located in High Tax States</td>
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<td>• Geography Well-Suited to Franchise</td>
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<td>• Overdealered Markets</td>
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New Unit Sales Crater in March as Much of the Country Is in Lockdown

The US economy has never been through an event like this one. Economic activity slowed dramatically and over 40 million jobs were lost in just a few months. Auto sales for March contracted quickly to just 11.35 million units on a seasonally adjusted annualized basis (SAAR), down 35% from 17.36 million units a year ago. Sales fell even further in April, down 48% on a SAAR basis from a year ago. The good news is that April appears to be the bottom as SAAR in May was 12.21 million units. For all of 2020, many experts are projecting the industry will sell 13.5 million light vehicles, down 21% from 2019.

Big incentives from the Detroit 3 have helped boost sales at those dealerships, but another reason that sales have rebounded quickly in May is that many dealers have become more skilled at digital retailing. One major OEM told us that pre-COVID-19, only 20% of its dealers were able to help customers buy cars online, and that number had grown to over 60% of its dealers in May. If there is a silver lining from COVID-19, it may be that the pandemic forced retailers to move quickly in an area where they had been inching along. When fully implemented with tools and processes that help set price, evaluate the customer’s trade-in and handle F&I, digital retailing could help dealers to sell more cars with lower personnel costs. Customer satisfaction may also improve thanks to greater transparency and shortened transaction times.

Note: The 2020 SAAR estimates have been dramatically affected by current market conditions
Macroeconomic Indicators Are Volatile

The Coronavirus Has Brought the Long Anticipated Recession

Our economy was expanding at a steady rate up until March when many businesses ceased operations and the massive job losses began. Even with a stimulus package, Q1 GDP declined at an annual rate of -4.8%. GDP in Q2 is expected to contract a stunning 32% according to the Wall Street Journal. For the entire year, the consensus outlook is that GDP will fall 5.5% in 2020 and then rebound 3.3% in 2021. But these projections are fluid and actual GDP could vary significantly from these figures depending upon the shape (V, U or W) of our recovery.

Unemployment Skyrocketed But Is Now Falling

The Unemployment rate has reached it’s highest levels since the Great Depression at 14.7% as of April. The biggest job losses are at the lower end of the wage scale, often employees of restaurants, travel related businesses, and even health care workers. A whopping 39% of people who make less than $40,000 were unemployed in April. These workers have been supported by $600 weekly Federal unemployment benefits in addition to state unemployment benefits, so their incomes may have actually risen during the crisis, although few are feeling confident and the federal benefits are due to expire in July. As cities and states reopen for business, 2.5 million of these workers have already been called back causing the unemployment rate to drop to 13.3% in May.

Fuel Prices Are Low

The recent spike in oil supply by Saudi Arabia and Russia in combination with falling demand from the pandemic led to an unprecedented collapse in oil prices in April. At one point, traders were paying buyers to take oil off their hands as they had no place to store it. The result is lower prices at the pump with the national average price per gallon of $1.80 in May 2020. Low gas prices boost auto purchases as consumers have more discretionary income. Given that the rest of the world is suffering an economic slowdown, we expect fuel prices will remain low for many months to come, helping to boost auto sales.

Sharp Decline in Vehicle Miles Driven

The stay at home orders placed throughout the country have had a material change on travel and the number of miles driven. Travel on all roads and streets declined by ~18.6%, or 50.6 billion vehicle miles, in March 2020 as compared with March 2019. The Northeast region declined the most with a 21% decline in vehicle miles driven. The number of miles driven is a key metric for auto sales as it is a pure measure of demand. When consumers drive fewer miles then their demand for replacement vehicles falls.

Interest Rates Are at Rock Bottom

The Fed cut overnight lending rates all the way down to 0.25%, and plans to keep these rates through the remainder of the year. One year ago the rate was 2.5%. The lower rates are intended to stimulate the economy. Low rates make it easier for consumers to afford auto purchases. The low rates also boost profits for dealers by reducing floorplan expense and mortgage payments.

Consumer Confidence Is Low, But We Are Past the Worst

According to the University of Michigan, the preliminary Consumer Sentiment reading was 78.9 in June, an increase from 72.3 in May and 71.8 in April, and is now at levels last seen at the end of 2013. The latest report indicated consumers saw “... gains in the outlook for personal finances and more favorable prospects for the national economy due to the reopening.” However, it also warned that nearly half of consumers still expect a renewed downturn due to a resurgence of coronavirus and slow employment recovery.
Used Vehicle Values Plummeted But Have Rebounded

Many analysts were concerned that used vehicle values were collapsing in the early weeks of the pandemic. This could have led to billions of dollars of losses across 17,000+ dealerships. Traditional auctions were shut down, auto dealers were closed, and tens of millions of consumers were losing their jobs. But in April prices hit bottom and have been regaining ground quickly. The rebound was caused by a big lift in demand for used vehicles. In fact, recent data from Cox Automotive showed that searches for used vehicles were at an all-time high.

Same-store used vehicle volume at public auto retailers was down 0.7% in Q1 2020 compared to Q1 2019. Privately owned franchised dealers are also increasingly focused on used, and the average dealer had a used-to-new ratio of 0.89:1.0 for Q1 2020. This ratio is up substantially from the 0.85:1.0 average in 2019. We expect this number to continue to grow as new inventory is supply constrained and the lower prices of used vehicles remain a draw for bargain hunting consumers.

New Vehicle Grosses Have Dropped Slightly

New vehicle gross profits per vehicle had been falling steadily since 2011, before increasing slightly in 2019. The first quarter of 2020 showed a drop again, down $102 per vehicle from the first quarter of 2019. We expect new vehicle gross profits to continue to fluctuate in 2020 as the supply/demand balance will likely change due inventory imbalances. Many dealers expect there to be shortages of hot products such as full sized trucks due to plant closings in the March-May time period. We will likely see the OEMs dial back incentives if the supply of vehicles continues to contract relative to demand. The last time we saw a supply shock was in 2011, caused by the Japanese tsunami and Thai floods. Dealers compensated for a lack of inventory by raising prices. It’s possible that higher margins for the remainder of the year could compensate for a drop in sales for the year, making overall gross profits for new vehicle departments to turn out similar to gross profits from 2019.
As for used vehicles, the average gross profit per used vehicle for the publics slid $10 from Q1 2020 compared to Q1 2019. It will be interesting to see how gross profits for used cars perform for the rest of the year. As we stated above, consumers are searching for used cars at higher rates than ever before. Perhaps dealers will have some pricing power and be able to generate stronger profits than in the past, helping to compensate for a tough Q2.

Finance & Insurance Departments Are Generating Record Profits

F&I profits per vehicle continue to increase as transaction values go up and retailers do a better job on product penetration. The public companies earned $1,729 per vehicle retailed in F&I gross profit during Q1 2020, up a whopping $131 (8.2%) from Q1 2019. This increase is significant and more than offsets the decline in gross profit on new and used vehicles. AutoNation has set the pace for the rest of the publics, generating F&I income of $2,100 per vehicle retailed. Private dealers also enjoy substantial profits that can be made through self-owned reinsurance companies. A Toyota dealer, for instance, making $2M at his store is likely making another several hundred thousand dollars in his reinsurance company.
Combined Front and Back: Profits per Vehicle Retailed Continue to Increase

The tables below track combined front and back end profits per vehicle retailed data back to 2010. They show that on a combined basis, profits have trended up slightly in absolute dollar terms as the gains in F&I have more than offset the declines in front-end gross.

PUBLIC COMPANY VEHICLE GROSS + F&I PVR

Weighted Average Same Store Performance – In Current Dollars

<table>
<thead>
<tr>
<th>Year</th>
<th>NEW Vehicle Gross</th>
<th>USED Vehicle Gross</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>$3,494</td>
<td>$3,906</td>
</tr>
<tr>
<td>Q1 2019</td>
<td>$3,875</td>
<td>$3,016</td>
</tr>
<tr>
<td>Q1 2020</td>
<td>$3,906</td>
<td>$3,138</td>
</tr>
</tbody>
</table>

NEW F&I TOTAL

-224 +635 +412
-9.3% +58.1% +11.8%

USED F&I TOTAL

-424 +635 +211
-23.1% +58.1% +7.2%

Note: Front end gross profit includes manufacturer incentives and other income.

Source: SEC filings; F&I as reported for new and used combined

Fixed Operations Grew, But May Soon Decline

According to NADA, fixed operations sales grew 4.0% for the average dealer over the last twelve months ending March 2020. This growth reflected about 50 weeks of good results and two weeks of poor results. The coronavirus put a stop to the growth in fixed operations that has been ongoing since the Great Recession ended in 2009. With the loss of jobs and a shift to people working from home, the number of miles driven fell in Q1. Fewer miles driven means less maintenance, fewer repairs, and fewer collisions that feed body shops and consumer parts. The public companies reported an average of a 1.2% same-store decrease in Q1 2020 compared to Q1 2019 as fewer customers made it into service drives in March.

FIXED OPERATIONS GROWTH

Source: NADA
Dealership Gross Is Down and Expenses Have Been Cut

The average privately-owned dealerships total gross profit from all departments (including other vehicle income) declined by 4.8% in Q1 2020 compared to Q1 2019, while operating expenses shrunk by just 1.9% compared to the same period in the prior year. Dealership selling, general and administrative expenses as a percent of gross profit increased from 84.8% in Q1 2019 to 87.4% in Q1 2020.

To offset the decline in gross profits, dealers have cut their expense structures to operate as leanly during the pandemic. They have reduced advertising expense as they continue to move into digital media and touchless transactions. Also, staff reductions have allowed dealers to only bring back their “A” teams when sales volumes require it (proceeds from the PPP program have also helped optimize employment expenses). Finally, dealers have lower floorplan and mortgage expenses. With the Fed Fund rates at 0-0.25%, net average floorplan expense per vehicle retailed decreased from $96 for 2019 to $51 in Q1 2019.

Dealership Profits Are Declining

The outcome of the trends above is average profits at privately owned dealerships decreased 4.5% over the last twelve months ended in March 2020 compared to 2019. That means profits in the first quarter were particularly low to have this much of an impact in just three months. We expect profits to decline more in Q2 as many dealerships were closed or had limited operations in April and May. The table below shows the annual profits at privately owned dealerships since 2010.

"EBITDAC" MUG

Earnings before interest, taxes, depreciation, amortization and coronavirus

Please contact us if you would like a Haig Partners “EBITDAC” mug.

Supplies are limited so email us today.
Despite the impact of COVID-19, some dealers are telling us they are having record profits in May. They explain that many consumers are still generating good income, have thousands of dollars in stimulus money to spend, and want to get out and do something. They are also motivated by high incentives and a growing belief that dealers are going to run out of inventory later this summer. It’s too soon to know if these strong profits are widespread and an indicator of better times to come, or a temporary spike that will level off as stimulus spending wears off, there are other ways to spend money, incentives drop, and the impact of tens of millions of job losses sets in.

**Changes in Sales for Individual Franchises**

The following chart sets forth the change in new unit sales among the major franchises in Q1 2020 compared to Q1 2019. Other than Kia, all franchises saw declining sales with many of the luxury brands, like Porsche and BMW, being hit hard. Nissan was struggling before the pandemic and today's circumstances are only accelerating its challenges. Note, this data reflects changes in total sales per franchise, so it includes fleet sales that can cloud results at the retail level.

**Q1 2020 VS. Q1 2019 SALES PERFORMANCE**

Source: Automotive News (March 2020 Data)
**Private Dealership Values Have Declined**

Average dealership values have fallen with lower current profits and the likelihood of lower profits for the next year. Given the temporary interruption of sales and service activities in most markets, we don’t believe the traditional model of valuing dealerships is valid today. This method of calculating blue sky value places a heavy emphasis on the past twelve months of profit. This profit has been suppressed in Q1 and is likely to fall further in Q2. As a result, recent performance is not a good predictor for future performance.

Instead of including 2020 results in dealership valuations, we believe many buyers are either:

- Historical Results: Looking at 2019 results as a baseline of what profits could be in the future, and then placing some discounts on those figures when valuing dealerships; or
- Projected Results: Projecting what a dealership could make in the future, factoring in ongoing pain from the coronavirus.

From either perspective, the result is that we are seeing buyers value most stores at approximately a 10% discount to what they would have been worth at the end of 2019. We explain the range of this discount in greater detail in the Buy-Sell Trends on page 18. If using 2019 numbers for their valuations, the average blue sky multiple on 2019 earnings has fallen about 0.5x from 4.7x at the end of 2019 to 4.2x at the end of Q1 2020. If looking into the future, buyers are still using the year end 2019 blue sky multiples, but estimating future profits as about 10% lower than they were in 2019. In either case the math points in the same direction. As the chart below shows, we estimated the average blue sky value per dealership has fallen from $6.7M to $6.1M.

**Public Dealership Values Fell Sharply But Are Rebounding**

The share prices of the public franchised retailers fell sharply earlier in 2020 as investors became concerned about the impact of COVID-19. Fortunately, we have seen a steady recovery for these share prices since the end of March as data emerges about the return of sales and service business. Their prices are now down 14% since the beginning of the year, compared to a full recovery for the S&P 500. It’s also interesting to note that the publicly traded used retailers have
fared better during the pandemic. Some of this is due to a consumer preference for used cars today versus new, but a big part of the story is that Carvana raised over $2.5B in equity and debt to fund its continued growth. Its stock price has increased 24% so far in 2020.

How Will the Coronavirus Impact Auto Retail?

There are short term effects of the coronavirus on auto retail, such as government mandated shutdowns, loss of jobs, loss of production, higher incentives, stimulus checks, etc. These impacts will likely play out over the next 6-12 months as our industry stabilizes from the severe shock that we are still enduring. CEOs of the publicly traded retailers have a hard time giving their investors guidance today on how the rest of the year will pan out. It’s possible the rebound in business dealers are seeing in May will continue for the rest of the year. But it’s also likely that the 40 million people who lost their jobs will spend less money on buying and servicing vehicles. Plus, COVID-19 remains a wildcard. If scientists can create an effective vaccine in the near future then the world can begin to return to normal. But if not, and the pandemic rebounds, we could have more shutdowns, more job losses, and a prolonged recession. The next few months will indicate whether we have a V, U, or W-shaped recovery with unpredictable ups and downs.

Some dealers are now beginning to consider the long-term impacts of the pandemic on our consumer behavior and how it could impact our industry. They can see several positive and negative factors. First, people have already become more concerned about relying on public transportation and ride sharing. Some may reconsider living in densely populated cities, as residents of those areas have been most at risk from the pandemic. Suburban and rural areas may become more appealing. The pandemic could cause these people to purchase more vehicles in the future.

There are also factors that could reduce sales in the future. Certainly, it will take time for 40 million workers who lost their jobs to regain employment and their ability to purchase vehicles. But many employees who kept their jobs have been learning to work remotely from their homes. A portion of these workers may continue to work from home even when COVID-19 is no longer a factor. They will drive less which would likely suppress the demand for vehicle sales and service. Some households could go from two vehicles to just one over time.

And there are some changes which appear to be occurring which could impact the dealer base unevenly. A number of consumers today have decided they prefer to purchase vehicles online, some due to a concern about interacting with dealer staff, and some due to the simplicity and transparency. Carvana has been doing this for years, but now a majority of dealers are offering some form of digital retail capabilities. It’s possible that after COVID passes a significant portion of consumers will prefer digital retailing and favor those dealers who do it best.

A good number of dealerships, perhaps 10%, were losing money before the coronavirus hit. Some of their owners may choose to close them permanently if they are unwilling to fund the losses that may continue for the foreseeable future. We can see this happening with 2-4% of the dealerships currently in operation, particularly in areas of the country like CA and the Northeast that are over-dealered and/or where property values have appreciated significantly. Their gains on the sale of the real estate can help to offset their operating losses. The surrounding stores will benefit as they gain more customers without an increase in fixed expenses. The result is that dealerships might become even more profitable than they have been in recent years. We saw this occur partly as a result of the 1,500+ GM and Chrysler dealerships that were terminated during the Great Recession. Average profits at the remaining dealerships more than doubled from their level before the terminations, from about $600K per year in 2015 to $1.1M-$1.5M over the past decade even though new unit volume has been about the same as before the Great Recession.
BUY-SELL TRENDS

The Buy-Sell Market Plummeted During the Last Downturn

The most recent shock we had to the buy-sell market was the Great Recession. Dealership profits fell significantly in 2008, and so did the buy-sell market. Buyers had less access to capital and were worried about preserving their own businesses, not expanding. The public companies had been spending $500M to $1B a year on purchasing dealerships before the Great Recession, but this figure dropped to just $14M in 2009. For three years, the publics spent very little in acquiring dealerships. When sales rebounded, so did dealership profits and acquisition spending. In 2011, just two years after the bottom of the cycle, the public companies spent $500M on dealerships.

While the Great Recession was preceded by a massive real estate bubble that then required years of painful restructuring for families and banks, many experts believe the current situation is much better. This is a health event that could pass in this calendar year if a vaccine can be developed. If so, then we will have a faster recovery, and dealership buy-sells should recover quickly as well.

The Buy-Sell Market Fell in Q1 2020

COVID had a large and negative impact on the buy-sell market in Q1 2020. The market had been relatively strong in January and February, but deals began to be put on hold or cancelled in March when COVID began leading to deaths, business closures, and the loss of so many jobs. Our data shows that 34% fewer rooftops traded hands in Q1 2020 compared to Q1 2019. Perhaps the best-known deal that was a COVID casualty was Asbury Automotive’s $1B acquisition of a group of dealerships in Texas. This would have been the largest transaction in auto retail since Berkshire Hathaway’s acquisition of the Van Tuyl Group in 2015. Asbury’s stock price had fallen by 60% between 12/31/2019 and March 18th, making it harder to justify the transaction to its investors.

The Current Perspective of Buyers and Sellers

We have been speaking with many leading dealership groups, attorneys who conduct buy-sell work, lenders who provide capital for acquisitions, and CPAs who provide due diligence and closing services for buy-sells. Based on what we have learned from these players in auto retail and from our own practice, there are still many groups that would like to grow, and many dealers who would like to sell. This is an encouraging recipe for a rebound in the buy-sell market.
As for the buyer perspective, this is what we are hearing in most parts of the country:

- We are past the worst of the impact and profits for the rest of the year could be surprisingly good.
- They believe the media frenzy will subside as health organizations begin to come up with solutions as they have in the past for the H1N1 flu, Zika, SARS, Ebola and other life-threatening ailments.
- They are hopeful the pandemic will push some dealers to sell attractive assets.
- Even though they are focused on the long-term and expect profits to rebound, they expect some discount from previous values to move forward on transactions.

The seller perspective in areas of the country impacted by COVID-19 is not that dissimilar:

- They expect their profits will rebound quickly, although not all the way back to 2019 levels.
- They are willing to take a slight discount to sell today, but would rather wait for conditions to improve than take a significantly lower price.

As you can see, the challenges to getting deals done in this market are going to be timing and valuation. The most likely outcomes for transactions that began prior to COVID-19 are:

- Terminated. The agreements between the parties have been cancelled and there are no current discussions between the parties;
- Postponed. Any agreements between a buyer and seller are still intact, but the buyer is waiting for clarity of future profits before proceeding; and
- Repriced. The parties are moving forward to closing, but the goodwill has been reduced from the original amount to compensate the buyer for the likely loss of profits for the balance of 2020.

The Outlook for Buy-Sells for the Remainder of 2020

There are a number of transactions that were structured pre-COVID which are moving forward. Most of these will be delayed until July to allow dealers who received PPP funds to retain them. Also, it would have been difficult to have a closing in April, May or June as the teams needed to close a transaction in most markets wouldn’t have been able to work together, floorplan lenders could not have travelled to closings, and DMVs were shuttered. As a result, we think Q2 2020 will show very little buy-sell activity.

From July onward, however, we expect dealership buy-sell activity to come back to life. At the risk of “jinxing” transactions in our pipeline, we expect to close on transactions representing more than 25 rooftops between now and the end of Q3 2020. These transactions are occurring in many states around the US, so demand for dealerships is widespread even if some areas, like the Northeast, have been hit harder than others.

Some Dealerships Have Maintained Value

We have estimated that the value of an average dealership has declined 10% since the end of 2019, but there are some dealerships who have suffered no loss in value, such as dealerships in regions where COVID was not a factor and there have been few job losses. Also, we have not seen any meaningful loss in value in underperforming dealerships that represent leading brands. We are currently representing two midline import dealerships with upside potential and their values have been unimpacted during this period. Buyers of underperforming stores understand that they will need to spend months, or even years, working to get them to their potential, so they are less concerned with 2020 performance.

Some Dealerships Are Difficult to Sell Today

On the opposite end of the spectrum would be the value of any high performing stores. Given the uncertain environment, relatively few buyers today are looking to write checks for large amounts of blue sky and high performing stores can be much more expensive than normally performing dealerships. The transaction that Asbury terminated in Texas is a good example as that group owned dealerships that were known to be high performing. Lenders may also be unwilling to extend lots of debt to fund expensive acquisitions until conditions rebound.
Dealership Valuation Methods

There are various ways to value dealerships. Since many dealers employ it, we will refer to the traditional method of combining blue sky (calculated as a multiple of the adjusted pre-tax profits), plus the value of other assets acquired. Adjusted pre-tax income excludes non-recurring income or expenses. Note, the significant change we see at present is that buyers are not looking at the most recent earnings period, the last twelve months as a guide for making their offers. Instead, there are two ways that we see buyers formulating their offers today:

- **Historical Results**: Many buyers are basing their offers on 2019 (pre-COVID) adjusted pre-tax profits instead of the most recent twelve month period. They assume that future profits are going to be similar, but lower. To compensate for lower profits, they are using blue sky multiples that are about 0.5x lower than those used in 2019 to get the same return on investment.

- **Projected Results**: Other buyers are estimating what they believe the store might make in the twelve months after closing and basing their offer based off these projected earnings. This means that weak months like March and April will be excluded from their calculation of blue sky. Our new favorite accounting term, EBITDAC, or "Earnings Before Interest, Taxes, Depreciation, Amortization and Coronavirus," may be heard regularly in conversations between sellers and buyers who are using this method. These buyers are using blue sky multiples that were largely in effect at the end of 2019, so the same multiples, but on lower pre-tax profits.

Either method is resulting in an estimated 10% decline in blue sky values for “average” dealerships compared to their values at the end of 2019.

The blue sky multiple ranges that we set forth in this report reflect our expectations of what motivated buyers in competitive situations will pay for the goodwill of average dealerships in the current marketplace. These expectations are based partly on the 13 transactions we have been involved in since the pandemic hit, as well as conversations with many buyers and dealer advisors involved in the buy-sell industry. We have chosen to reflect blue sky valuations of dealerships based on a multiple of historical earnings rather than projected earnings as we feel that this method more clearly shows that there has been a decline of about 10% in the value of most dealerships. We remind the reader that each dealership transaction is unique, and dealerships may trade above or below the ranges we describe in this report. See page 6 for factors that could increase or decrease the multiples paid by buyers from what we estimate here.
Luxury Franchise Blue Sky Multiples

**Porsche**

After a record 2019, Porsche saw sales down 20.2% through the first three months of 2020 versus the same time last year. Few consumers “need” a new Porsche and the factory has not been generous with incentives. Before the pandemic, Porsche was riding high with consumers and dealers. It had reached the top of Consumer Reports 2020 brand rankings, and profits per vehicle were higher than at almost any other brand. Consumers are showing a lot of demand for the upcoming electric vehicle, the Taycan, which could help to boost sales later this year. Porsche stores are rare and can be highly profitable, so long-term demand is still solid. Lower multiple range on 2019 adjusted pre-tax profit: 8.0x–9.0x.

**Mercedes-Benz**

Mercedes-Benz reported a sales decrease of just 4.3% in the first quarter, better than any other luxury brand. Its recently refreshed lineup of SUVs was a big help. MB stores have been performing well recently, overcoming a two-year slide. Dealer profits have jumped significantly and remain among the highest of any franchise. We recently advised on the sale of a Mercedes-Benz dealership in the Midwest and it drew significant interest from buyers. Lower multiple range on 2019 adjusted pre-tax profit: 6.0x–7.5x.

**Lexus**

Sales at Lexus dealerships in Q1 2020 were down 15.6% compared to the same time last year, a little more than the overall market decline. Consumers still love Lexus’ quality and the brand enjoys the highest resale value, which boosts its ability to lease vehicles cheaply. Dealers have been grumbling a bit about aging products, and have become accustomed to low profits per unit retailed. High volumes and excellent fixed operations have outweighed low grosses, so dealer profits remain strong. Lexus is beginning to realign its product portfolio, dropping the slow selling GS and promising a new full-size SUV, the LQ, as a 2022 model. This will help Lexus dealers capture sales in the rapidly growing full-size SUV segment where margins are stronger. Lower multiple range on 2019 adjusted pre-tax profit: 6.0x–7.5x.

**BMW**

The brand saw its sales drop 15.3% in Q1 after an impressive 2019 in which BMW regained the luxury sales crown. Dealer profits were high in 2019 as sales were increasing and margins had reached impressive levels in many parts of the country. We saw front end gross profits, including all incentive and bonus money, in the $6,000 range in several parts of the country. BMW’s product line is well-balanced with small to large coupes, sedans and SUVs. Improved electric vehicles are also on the way in the next year or so. We recently sold a BMW franchise in the Southeast and there was strong interest. Lower multiple range on 2019 adjusted pre-tax profit: 6.0x–7.5x.

**Audi**

Sales declined 14% in Q1 compared to Q1 2019, about average for the market. Consumers continue to praise Audi products and Audi has a well-balanced product line-up, with products in most major categories and widely spaced pricing. Some dealers have been disappointed with Audi as its profitability is noticeably lower than at BMW, Lexus and M-B dealerships, its closest competitors. Its expensive facility requirements and loaner program are part of the issues that dealers point to. For these reasons, Audi is less in demand from buyers so it trades at a lower range from its peers. Lower multiple range on 2019 adjusted pre-tax profit: 5.5x–6.5x.

**Jaguar / Land Rover**

Following years of record sales, the company reported a 30.9% decline in sales during the first quarter of 2020, far worse than the overall market. Its elegant and distinctive products have been attracting wealthy consumers who have been willing to pay premiums for the full-sized Range Rover and the Range Rover Sport. Dealer profits have been rising for years, thanks to these premium products and busy service drives. Jaguar is a drag on the performance of this franchise, and we wonder how long the JLR executives will require dealers to treat them equally in terms of showroom space. Factory closures have hampered Land Rover’s rollout of the much-anticipated Defender SUV, forecasted to lift sales in 2020. Due to its expensive facilities and incoming add points, JLR trades at a lower range from the premium luxury brands. Lower multiple range on 2019 adjusted pre-tax profit: 5.5x–6.5x.
Volkswagen
Sales decreased 11.7% during the first quarter of this year, slightly better than the overall market. Volkswagen sales had been rising quickly in recent years thanks to its attractively styled SUVs, which accounted for 68% of its sales so far this year. Volkswagen dealers need more volume to help generate higher profits today, and to build a higher number of units in operation to help their service departments in the future. Volkswagen has bet heavily on electrification, which may not yield expected results given low fuel prices. Lower multiple range on 2019 adjusted pre-tax profit: 3.5x-4.5x.

Acura
Sales decreased 21.6% in Q1 compared to Q1 2019, worse than the market average. Acura is hoping that new models would boost its sales in 2020 and give it one of the freshest lineups in the industry, with 75% of its portfolio less than a year old. Brand consideration is at a five-year high. New product is exactly what Acura stores need, as many dealers have been suffering from low sales per location and low margins, making profitability a challenge. Until profits jump, we expect demand to remain low for this franchise. Lower multiple range on 2019 adjusted pre-tax profit: 2.0x-3.0x.

Infiniti
Infiniti reported a sales decline of 25.5%, second only to Nissan as the worst performing of all major brands. Infiniti suffers from an aging product line and there is little help in sight. Many dealerships were not profitable in 2019 and we wonder how 2020 can be any better. We expect a number of infiniti dealerships will close this year as their owners choose to stop funding losses and convert their properties to other uses. Infiniti's parent company, Nissan, announced a $6.2B loss for the first quarter as it wrote down the value of a number of its assets. The good news for US dealers is that Nissan announced it was going to retreat from some markets so it can increase its focus on core markets like the US. We hope this will mean greater investment in product and marketing support for US dealers. Lower value range: $0-$1,500,000.

Cadillac
Cadillac sales decreased 15.8% in Q1 2020, slightly worse than average. The virus has also caused a delay in the upcoming releases of the new high-performance variants of Cadillac's new sedans. What will likely help dealers more is the new Escalade which is expected to arrive late in the year. These models may help boost sales, but there remain too many Cadillac stores in most parts of the US so profits per location remain low. Lower value range: $0-$1,500,000.

Lincoln
Lincoln sales are up 2.3% in Q1 2020 compared to 2019, adding to the sales gains it made in 2019. Its new products are nicely styled, but its franchise network is in disrepair after a decade or so of neglect. Regrettably, rather than allow dealers to simply sell Lincolns and begin to profit from the franchise, Lincoln is trying to force many dealers into building free standing and costly facilities. The fixed overhead of these facilities would likely erode profits for some time until the brand can build its sales to a much higher level. Also, there are too many Lincoln stores so profits per store are likely lower than at Cadillac. Lower value range: $0-$1,500,000.

Mid-Line Import Franchise Blue Sky Multiples

Toyota
The Toyota brand posted a 7.9% decrease in Q1 sales this year, significantly less than the overall 13.1% drop in sales. Toyota has been more aggressive with incentives than many other OEMs so it has been taking market share. Toyota dealerships remain in high demand thanks to its business model that provides high volume new vehicle sales and strong fixed operations. Toyota enjoys the second highest brand loyalty with consumers. We are involved in the sale of two Toyota dealerships and interest is strong even in the midst of the pandemic. Lower multiple range on 2019 adjusted pre-tax profit: 5.0x-6.0x.

Honda
After a strong start to the year, Honda sales fell sharply and are down 19.2% in Q1 2020. Consumers remain loyal to the brand, with the third highest ranking of all brands, but Honda has not been giving people many reasons to come out and buy vehicles. Its incentives are lower than some other OEMs so it has lost market share this year. We expect it will regain this lost share over the remainder of 2020 as incentives may not be needed due to inventory constraints. Many dealers seek this franchise thanks to its consistent and strong profits per location. Lower multiple range on 2019 adjusted pre-tax profit: 5.0x-6.0x.

Subaru
Subaru reported its first monthly and quarterly drop in eleven years, with a 16.7% decrease in sales in Q1. This must have been a shock to every dealer as they have become accustomed to steadily increasing sales. Consumers continue to support the brand, as Subaru received the top ranking for customer loyalty, according the JD Power. Dealers are always short of inventory with this brand, but with the plants being closed for April and May, sales may continue to suffer. We hope dealers are adjusting their pricing upward to make up for the lack of supply. Subaru dealers remain happy and dealers of other brands are seeking these franchises. We are involved with the sale of two Subaru stores and demand for them has been strong. Lower multiple range on 2019 adjusted pre-tax profit: 5.0x-6.0x.

Volkswagen
The Volkswagen brand saw a 13% decrease in sales in Q1 YoY, about average for the industry. The brand continues to recover from Dieselgate with brand loyalty rate reaching a 10 year high in 2019. Dealer profits have been inching up, but sales per dealership are still lower than most other franchises and margins are not very high. We worry a little about the future at VW as so much of its development budget has been for electric vehicles which may find limited interest in this era of low fuel prices. Dealers are pleased with the top management at VW in the US and its plans to make VW “cool” again. Lower multiple range on 2019 adjusted pre-tax profit: 2.5x-3.5x.

Kia
Kia performed better than any other major brand, squeezing out a 1% increase in sales through Q1 2020. Dealers found lots of buyers for the new Telluride and updated Sportage CUVs. Kia should also outperform the market for the rest of 2020 as its plants in
South Korea never shut down due to the pandemic. Kia dealers will have inventory while many other brands will be suffering. We are hopeful that Kia will assist dealers in developing higher fixed operations. Today, most of the profits for Kia dealers are coming from new vehicle sales which may be depressed for a while. **Lower multiple range on 2019 adjusted pre-tax profit: 2.5x–3.25x.**

**Hyundai**

Hyundai’s sales declined 11% in Q1 versus the same period last year. Its new products have been well received with the Palisade selling for full sticker, when dealers can get them in stock. It recently launched a nicely designed Sonata which should help sales. And like Kia, much of Hyundai’s production is based in South Korea and its plants did not shut down during the pandemic. As a result, Hyundai dealers may have plenty of inventory to sell during the summer months, helping them to gain share. The head of styling recently left, which could hurt sales in the future. Hyundai continues to push its Genesis luxury brand and has invested billions of dollars in product development. The products get excellent reviews, but it will be a long road to reach other near luxury brands like Acura and Infiniti. We are hopeful dealers will find a way to sell these products without committing to expensive facilities. **Lower multiple range on 2019 adjusted pre-tax profit: 2.5x–3.0x.**

**Mazda**

Mazda’s year to date sales were down 4.5%, much better than most brands. Its products are performing better, and some dealers have figured out how to get lots of margin from the sale of these vehicles. For those who understand the brand, these dealerships can provide very attractive returns on investment. However, given the low volumes, few dealers are targeting this brand. **Lower multiple range on 2019 adjusted pre-tax profit: 2.25x–3.0x.**

**Nissan**

The brand is down 29.6% through the first three months of the year, the worst performance for any major franchise. Nissan is in a period of restructuring as it accepts the reality that it tried to sell too many vehicles in too many markets, including the US. The company reported a $0.28 loss for the first quarter as it wrote down the value of many of its plants. For the past couple of years Nissan dealers in the US had been complaining of unrealistic and unfair stair-step programs that eroded resale values, customer loyalty, and dealer profits. New management is taking steps to help dealers in the US, including higher incentives and additional marketing. What is needed most is fresh product, and that appears to be some time away. Many dealers have thrown in the towel on the franchise and will not consider it for future acquisitions, but some are willing to consider an acquisition if the price is low and the location is good. **Lower multiple range on 2019 adjusted pre-tax profit: 1.5x–2.5x.**

**Domestic Franchise Blue Sky Multiples**

**Ford**

Ford sales decreased 13.2% in Q1 versus Q1 2019, about the same as the overall market. Ford has been running 0% interest for 84 months on 2019 models, but these incentives are dropping as its dealers are beginning to run short of supply. With its factories closed in April and May, Ford has announced it will be running extra shifts and skipping its normal two-week summer shut-down in order to rebuild inventories. The drop in gas prices will likely favor Ford given much of its sales come from large trucks and SUVs. Ford has important product launches in 2020, including the redesigned F–150, the return of the Bronco, and the new Mach–E electric SUV. Buyers have been a little wary of this franchise in recent years due to the uncertain directions of its senior management, but these new products are likely to stimulate more demand. We are involved in the sale of three Ford stores and demand for them was solid. **Lower multiple range on 2019 adjusted pre-tax profit: 2.5x–3.5x.**

**Chevrolet**

Chevrolet sales fell 3.8% in the first quarter, much better than the overall market. Chevrolet has also been offering 0%–84 months, but this is ending as dealers are running out of inventory of high-demand models. Chevy dealers say they had not yet fully recovered from the strike last fall that eroded their inventory levels, so they appear to be in a worse position than their competitors. The Silverado that launched last year received mixed reviews, so dealers are hoping for a better reception for the upcoming Tahoes and Suburbans. The total redesign of the Corvette is bringing a lot of excitement to the brand. Dealers just started receiving them as COVID began to force shutdowns, but they are expecting strong volumes and high gross margins as consumers and critics have pronounced the sports car a big hit. We are in the midst of selling three Chevrolet dealerships and demand has been strong. **Lower multiple range on 2019 adjusted pre-tax profit: 2.75x–3.75x.**

**FCA (Chrysler-Jeep-Dodge-Ram-Fiat)**

Collectively, FCA’s combined brands saw a 10% decrease in sales in Q1, slightly better than average for the market. Digging under the covers a bit, we see the following performance by brand: Chrysler (-5%), Jeep (-14%), Dodge (-20%), Fiat (-48%), and Ram +3%. Many truck buyers believe that Ram has leap-frogged the competition with its redesigned full-size truck, particularly in the interior that feels more like a luxury, high tech ride than a work vehicle. FCA plans to merge with European car maker Group PSA which may help it produce more competitive sedans and CUVs than some of its current products. It will also help boost FCA’s overall competitive abilities as it will become the world’s third largest automaker, behind Toyota and VW. Few people call us looking for FCA dealerships, but they offer an attractive return on investment which could improve in the future due to the factors raised above. **Lower multiple range on 2019 adjusted pre-tax profit: 2.75x–3.75x.**

**Buick–GMC**

While Buick sales fell 34.7% in Q1 compared to Q1 2019, GMC sales did better than the overall market, down 5.5% in Q1. Like the situation at Chevrolet, dealers are now starting to sell through their truck inventories and are worried about running out later this summer. The Sierra continues to sell in good numbers and buyers seem to be willing to pay a premium for the product as it is increasingly differentiated from its brother, the Silverado. New Yukons will be arriving later this year and dealers are hoping for a positive reception from consumers. **Lower multiple range on 2019 adjusted pre-tax profit: 2.5x–3.0x.**
The auto industry took a heavy hit due to the pandemic. Fortunately, the recovery has already started as May sales and service figures jumped sharply from April. Many dealers are pinching themselves with profits in May that were, in some cases, at record high levels.

Most dealers have been pushed by the pandemic to restructure their operations. They added digital retailing to respond to demand from consumers for a safer, more convenient and transparent way of doing business. It will be interesting to see if consumer demand for buying online grows or is a temporary reaction to the coronavirus.

Dealers are also examining their staffing models and figuring out how to conduct business with lower compensation expense. And many dealers have been finding other ways to squeeze out all unnecessary costs such as renegotiating contracts with vendors. Lower interest rates have cut mortgage expense and floorplan expense, which are significant for most dealers.

In addition to reducing their expenses, dealers are focused on growing their used operations to compensate for lower new vehicle sales. And dealers are finding ways to make vehicle service and maintenance more convenient for customers to boost their fixed operations. Pick-up and delivery have become more common.

In combination, these changes are once again demonstrating the business acumen of the dealer body. Whether large or small, metro or rural, we expect dealers will emerge stronger and more profitable than ever before.

The buy-sell market has also been impacted by the pandemic. Most transactions that began before the shutdowns were cancelled, put on hold, or repriced. The number of dealerships sold in the US in Q1 2020 fell 34% from Q1 2019. Sales in Q2 will likely be even worse. On average, we believe blue sky values have fallen about 10% from year end 2019 to the end of Q1 2020 because of declining earnings.

Fortunately, the buy-sell market has also started to recover. We closed on the sale of a dealership in early June and expect to close on the sale of more than 25 additional stores by the end of Q3 2020. These dealerships are located in many parts of the US, even in the Northeast which was hurt more severely by the pandemic. These acquisitions demonstrate that dealers remain excited about the future of auto retail and have plenty of capital for acquiring businesses that are fairly priced.

Having been involved in over 180 transactions for more than 360 dealerships, no other firm has a better understanding of the perspectives of both buyers and sellers of dealerships across the U.S. We use this expertise to create highly informative and compelling offering materials that help buyers to focus on our clients instead of other opportunities. We listen to our clients to create a customized marketing process that carefully balances their priorities of maximizing price, preserving confidentiality, and time to closing. Through our unmatched expertise, deep relationships with buyers, and well-honed processes, Haig Partners is able to produce highly desirable outcomes for our clients.

**KEY TAKEAWAYS**
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